ISSN 1725-3209 (online)
ISSN 1725-3195 (print)

EUROPEAN ECONOMY

Occasional Papers 208 | December 2014

Post-Programme Surveillance for Portugal
Autumn 2014 Report

Economic and
Financial Affairs

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KC-AH-14-208-EN-N (online)
ISBN 978-92-79-38828-6 (online)
doi:10.2765/85803 (online)

KC-AH-14-208-EN-C (print)
ISBN 978-92-79-38829-3 (print)
doi:10.2765/85823 (print)

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European Commission
Directorate-General for Economic and Financial Affairs

Post-Programme Surveillance for Portugal

Autumn 2014 Report

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ACKNOWLEDGEMENTS

The report was prepared in the Directorate General Economic and Financial Affairs under the direction of Servaas Deroose, Deputy Director General and Stefan Kuhnert, Deputy Head of Unit for Portugal.

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EXECUTIVE SUMMARY

Following the end of the EU/IMF adjustment programme for Portugal in June 2014, this report presents the findings of the first post-programme surveillance (PPS) mission of Commission staff, in liaison with ECB staff, to Lisbon between 28 October and 4 November. *The mission was coordinated with the IMF's post-programme monitoring (PPM) mission, and staff from the European Stability Mechanism (ESM) participated in meetings of relevance to their Early Warning System. The aim of the mission was to assess Portugal's economic, fiscal and financial situation, and, when deemed necessary, to suggest undertaking corrective measures to preserve financial stability, fiscal sustainability and ensure sustainable economic policies. This will be assessed every six months until a minimum of 75% of the financial assistance has been repaid. Standard EU economic surveillance mechanisms, to which Portugal is again subject after the programme has ended, provided additional guidance on the content of policy discussions.*

While constructive and open discussions were held during the PPS mission, preparations faced difficulties due to late provision of data and information by the authorities which in many cases occurred only during the meetings.

Overall, the economic and financial conditions in Portugal have further improved since the end of the EU/IMF-supported programme in June. *Sovereign yields remain low, in line with developments elsewhere in the euro area and normal market-financing is being gradually restored. Nevertheless, economic recovery is constrained by high levels of debt in the public and private sector and by an increasingly weak external environment which highlights the need for further competitiveness gains. The pace of budgetary consolidation has been adversely affected by a series of one-off factors, despite strong revenue performance. Moreover, efforts to reduce the underlying structural budget deficit have clearly slackened. Progress in structural reforms has lost momentum, with an uneven pace of implementation across policy areas.*

The composition of growth in the Portuguese economy has shifted in recent months. *Weaker external demand and a number of temporary factors weighed on export performance in the first half of the year and led to a notable decline in the growth contribution from the external side. At the same time, domestic demand – and more specifically private consumption – has strengthened, supported by a strong labour-market performance. The Commission's Autumn Forecast expects economic growth in 2014 and 2015 to be slightly below the current projections of the Government. Risks to the near-term economic outlook are to the downside and are, in particular, related to uncertainty in the external environment.*

The Government expects a nominal budget deficit of 4.8% of GDP in 2014 (pending the statistical assessment of the Banco Espírito Santo (BES) resolution operation) which includes 1.1% of GDP deficit-increasing one-off factors that do not affect the budgetary position in 2015. *On 15 October, the Government presented its draft budget for 2015 which targets a nominal deficit of 2.7%. This target is higher than the 2.5% of GDP required under the Excessive Deficit Procedure (EDP) and committed to under the programme. The Commission's Autumn Forecast projects a nominal budget deficit of 3.3% of GDP for 2015 based, among other factors, on less optimistic assumptions on the budgetary impact of macroeconomic developments, the impact of the measures to fight tax evasion and fraud and of the consolidation measures. Meanwhile, the adjustment in the structural deficit also falls considerably short of what is required under the EDP, reflecting a fading consolidation effort. The 2015 draft budget confirms the reversal of some of the measures that contributed significantly to the consolidation effort in the last few years, notably concerning a reduction in the public wage bill and improvement in the sustainability of pensions, but does not contain replacement measures. The debt-to-GDP ratio, which stood at 128% at the end of 2013, is expected to be lower by the end of this year and to continue on a downward path thereafter, if supported by sufficiently high primary budget surpluses and nominal GDP growth.*

Fiscal-structural reforms are advanced, but strong implementation needs to continue. *Building on already successful Public Financial Management reforms, a comprehensive revision of the Budget Framework Law is to be completed and implemented. Further efforts on revenue administration reform are being made, including measures to fight tax fraud and evasion. Public administration reforms are proceeding, but some of them at a slower pace and with less budgetary impact than initially expected. The operating balance of state-owned enterprises (SOEs) improved considerably despite headwinds. Local and regional administration reforms are making good progress in terms of implementation, and renegotiations of several public-private partnerships (PPPs) are to be formally concluded. Following a Constitutional Court ruling earlier this year and in the absence of a broad political consensus, a comprehensive pension reform is no longer pursued. Health care system reforms with a view to ensure the sustainability of hospital SOEs are progressing, but reducing their arrears remains a challenge.*

Portuguese banks continue to deleverage amid improving liquidity conditions. *Their solvency ratios were progressively reinforced under the programme, but internal capital generation amid low profitability and only slowly recovering non-performing loan ratios remain a key challenge for the sector, not least in light of the domestic macroeconomic environment. Most lenders expect to end 2014 with a loss; nonetheless, transformation and cost-saving measures from the past few years are expected to finally yield positive results. Banking-sector developments in recent months have been marked by the collapse and resolution of Banco Espírito Santo (BES). BES's resolution effectively preserved financial, but looking forward the recapitalisation of Novo Banco leaves the banking system exposed to a contingent liability depending on the sale price of the new bank. The Comprehensive Assessment (CA) complemented a series of asset quality reviews and stress tests performed by the Portuguese central bank since 2011. While confirming the soundness of the Portuguese financial system, it identified a capital shortfall in one bank. Looking ahead the opportunity provided by the Comprehensive Assessment to strengthen further the resilience of the banking system as a whole needs to be seized. Progress on the implementation of tools to support an orderly deleveraging of the Portuguese corporate sector is notable but further effort is required in this challenging task. The establishment of the Development Financial Institution (DFI) is in its final phase. The institution should become fully operational in 2015. Its capital coupled with regional funds will be used to address market failures in SME financing.*

Progress in implementing structural reforms in labour markets, network industries, education, the housing market, administrative simplification, the judiciary, and the liberalisation of services and professions was monitored by the mission. *While some measures have been taken, for instance, in the educational system, the judiciary and in the energy sector, overall the pace of structural reform appears to have diminished considerably since the end of the programme, in some cases reversing past achievements. Notably, while it remains to be seen whether recent policy measures relating to collective wage bargaining could on balance contribute to a better alignment of wages to productivity developments, the decision to increase the minimum wage could make the transition into employment for the most vulnerable even more difficult. Efforts to reduce excessive rents in network industries, in particular in energy, need to be stepped up. Renewed momentum is necessary to fully complete and implement the reforms aimed at improving the regulatory framework and opening up sheltered sectors. Finally, there is a need to more systematically monitor and evaluate the impact of reforms. Looking ahead, maintaining an ambitious reform agenda to increase the flexibility and competitiveness of the Portuguese economy is not only important to enhance the medium-term growth potential, but also to underpin the still nascent economic recovery.*

The appetite for bold reforms seems to have disappeared in recent months, and a broad-based consensus on a medium-term growth strategy is not in sight. *Therefore, the mission urged the authorities to implement the reforms they committed to in the 12th programme review, in the context of the European Semester and to present a comprehensive reform strategy for the medium-term.*

Borrowing conditions have further improved since the end of the programme amid general market optimism and a continued search for yield, and the Treasury benefitted from this trend to build a strong cash position. *However, recent episodes of volatility in sovereign yields suggest that managing the financing of the high public debt burden will remain a challenge for some time. This notwithstanding, on the basis of the analysis in this report, repayment risks for the EFSM and EFSF loans are low at present. However, for this situation to persist going forward, it is essential that the authorities implement with resolve further structural reforms, public finances continue to be consolidated in a durable manner and access to credit markets is maintained.*

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1. INTRODUCTION

The EU-IMF financial assistance programme for Portugal ended in June 2014. The three-year programme had been approved by the ECOFIN Council and the IMF Board in May 2011. The economic adjustment programme provided financing by the European Financial Stabilisation Mechanism (EFSM), the European Financial Stability Fund (EFSF), and the IMF of up to EUR 78 billion. The objective of the arrangement was to put Portugal's public finances back on a sustainable path, ensure financial stability, implement structural reforms to restore competitiveness, and to fully regain international capital market access at sustainable rates.

Staff from the European Commission (EC), in liaison with the European Central Bank (ECB), undertook the first post-programme surveillance (PPS) mission to Portugal between 28 October and 4 November. The mission was coordinated with the IMF's post-programme monitoring (PPM) mission. The European Stability Mechanism (ESM) participated in the meetings on aspects related to its own Early Warning System. Preparations for both missions were hampered by the late provision of data by the authorities. In general, PPS aims at assessing the economic, fiscal and financial situation of the country having received financial assistance, to verify that policies taken are conducive to financial stability, fiscal sustainability and economic structures which ensure an efficient allocation of resources. While there is no policy conditionality under PPS, the Council can issue recommendations for corrective actions if necessary and where appropriate. PPS is biannual in terms of reporting and missions.

Following the end of the programme, the standard economic surveillance mechanisms from which it was exempted under the programme now apply to Portugal. During the programme, Portugal remained in the Excessive Deficit Procedure (EDP) of the Stability and Growth Pact, but the recommendations of June 2013 were based on the programme. Portugal received country-specific recommendations (CSRs) under the European Semester, as approved by the Council on 8 July 2014, which largely reflect the 'left-overs' of the programme and the Letter-of-Intent signed and published by the authorities after the non-concluded 12th programme-review. Under the Macroeconomic Imbalances Procedure, the Commission's Alert Mechanism Report presented on 28 November 2014 recommends further in-depth analysis into whether imbalances exist or risk emerging in Portugal.

This report lays down the European Commission's and ECB staff views on recent developments and main policy issues in Portugal. It summarises in particular the mission assessment of progress and challenges in macroeconomic adjustment, fiscal policies, financial stability, structural reforms and sovereign financing. The Annex provides an assessment of the recent increase in the minimum wage, a sustainability analysis of sovereign debt and supplementary tables with economic data on Portugal.

Box 1.1: Facts about Post-Programme Surveillance (PPS)

The aim of PPS is to provide assurances that a Member State, which has received external financial assistance, maintains its capacity to service its debt to the Community budget (EFSM) and the EFSF/ESM. In principle a Member State remains under PPS until a minimum of 75% of the financial assistance received from the EFSM, EFSF/ESM or other Member States has been repaid. ([1]) In view of the average maturity of loans between 15 and 25 years, PPS will thus apply for a significant period of time.

Under PPS, the economic, fiscal and financial situation of a former programme country is being assessed. The legal basis for PPS is the "Two-pack Regulation" EU No 472/2013. During review missions every six months, Commission staff, in liaison with ECB staff, will assess the economic, fiscal and financial situation, i.e. whether the positive economic and fiscal momentum which started under an adjustment programme have been consolidated. In case of serious concerns, the Commission can propose to the Council to recommend to the Member State under PPS to adopt corrective measures.

According to the regulation, the Commission's review missions take place in liaison with the ECB. Although not a legal obligation, coordination with the IMF's post-programme arrangements is taking place given that euro-area programmes are co-financed by the IMF. Without having a specific role in PPS, the EFSF/ESM has established its own "Early Warning System" (EWS), laying down certain reporting requirements of Members States having benefitted from financial assistance, which allow EFSF/ESM staff to monitor financial and risk exposures. ([2])

PPS provides for regular European Parliament and Member State involvement. The Commission, in liaison with the ECB, is required to communicate its semi-annual PPS assessments to the competent committee of the European Parliament, to the Economic and Financial Committee (EFC) and to the parliament of the Member State concerned. Moreover, the Regulation allows the parliament of the Member State concerned to invite representatives of the Commission to participate in an exchange of views on PPS findings.

The EU's regular preventive and corrective surveillance procedures fully apply in parallel during PPS. A former programme country will therefore receive again country-specific recommendations (CSRs) under the European Semester and will be subject to the Macroeconomic Imbalance Procedure (MIP), both of which were suspended for the duration of the macroeconomic adjustment programme. The Member State will also have to comply with requirements under the preventive arm of the Stability and Growth Pact (SGP) if it is not subject to the corrective arm.

([1]) PPS can be extended beyond the 75% capital repayment period if there is a persistent risk to the financial stability or the fiscal sustainability of public finances of the Member State concerned.

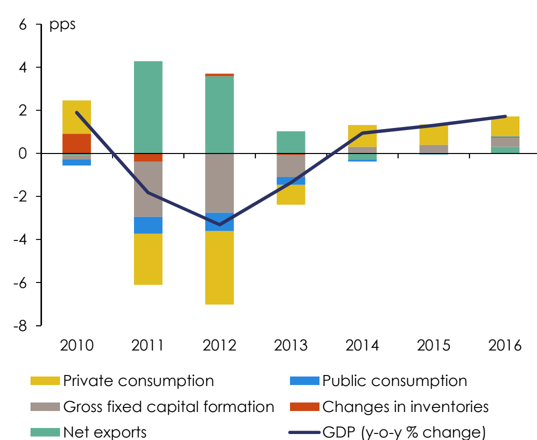
([2]) A proposal by the Commission can only be rejected by a qualified majority of the Council within 10 days of the Commission's adoption. The procedure is set out in Art. 14 (4) of Regulation EU No 472/2013.

2. RECENT ECONOMIC DEVELOPMENTS

Macroeconomic situation and outlook

Portugal's real GDP increased by 1% y-o-y (0.2% q-o-q) in 2014Q3, as anticipated in the Commission Autumn Forecast 2014. Private consumption posted solid growth of 1.9% y-o-y in the first semester of the year, in line with favourable labour-market developments. Fixed investment also held up well in 2014H1 (+1.6 y-o-y), due to buoyant machinery and equipment investment, notwithstanding weaker-than-expected construction activity. However, exports have lost momentum due to the weakening of external demand, but also due to temporary factors at play (temporary closure of a large refinery and an auto production plant), and have not been compensating for the increase in imports due to the rebound of domestic demand. According to the National Statistical Institute (INE)'s flash estimate, real GDP expanded by 0.2% q-o-q in the third quarter of this year. Although detailed statistics are not published yet, INE indicated that the main driver of output growth in the third quarter was private consumption, while net external demand recorded a negative contribution due to the acceleration of imports and the stagnation of exports. This outcome is consistent with the Commission Autumn Forecast.

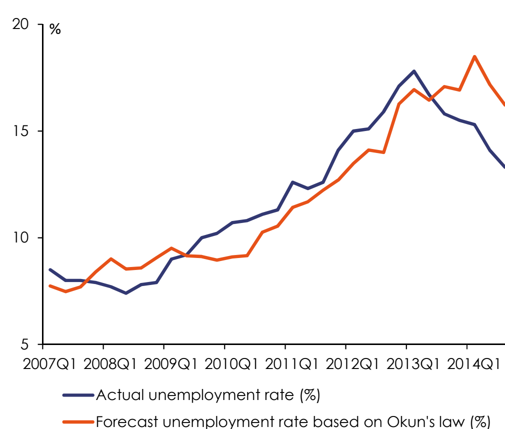
Graph 2.1: **Contributions to real GDP growth**



Source: Commission services

According to the Commission Autumn Forecast, real GDP is projected to accelerate from 0.9% in 2014 to 1.3% in 2015 and 1.7% in 2016. Fixed investment is expected to accelerate to around 3% by 2016, benefiting from resilient internal demand, low interest rates and increasing needs to restore capital stock. In contrast, the strong momentum in private consumption is set to wane amid continued deleveraging pressure on households balance sheets. Export growth is projected to rebound in 2015-2016 amid expected improvements in the external environment and broadly stable market shares. As a result, the net export contribution to GDP growth, which is expected to be negative in 2014, should gradually turn positive over the forecast period. Accordingly, Portugal's current account balance is projected to produce small surpluses from 2015 onwards.

Graph 2.2: **Unemployment rate: actual and based on Okun's law**



(1) Based on a static specification of Okun's law in first differences: $\Delta Ut = a + \beta^*Yt + \varepsilon t$, where ΔU is the change in unemployment rate, Y the GDP growth and ε the error term.
(2) The Okun's law describes the relationship between changes in unemployment rate and changes in output.
Source: Commission services

The labour market situation has markedly improved over the past year. Employment grew strongly by more than 2% y-o-y in third quarter of 2014 and the unemployment rate fell to 13.1% in the same period, supported by a 0.7 % y-o-y decline in the labour force. These trends imply some upside risks to the Commission Autumn Forecast, where employment is projected to increase by 1.6% in 2014 and to decelerate to 0.8% in 2015-2016, while the unemployment rate is expected to average at 14.5% in 2014 and decrease to 12.8% in 2016. Graph 2 illustrates that the reduction in unemployment over the past year has been much stronger than what could have been

Table 2.1: **Comparison between the EC Autumn Forecast 2014 and Draft Budgetary Plan (DBP) 2015**

	EC Autumn Forecast 2014				*DBP Portugal*	
	2013	2014	2015	2016	*2014*	*2015*
Real GDP (% change)	-1.4	0.9	1.3	1.7	*1.0*	*1.5*
Private consumption (% change)	-1.4	1.6	1.5	1.5	*1.8*	*2.0*
Public consumption (% change)	-1.9	-0.4	-0.3	0.2	*-0.6*	*-0.5*
Gross fixed capital formation (% change)	-6.3	1.9	2.4	2.8	*1.5*	*2.0*
Exports of goods and services (% change)	6.4	3.6	4.6	5.6	*3.7*	*4.7*
Imports of goods and services (% change)	3.6	4.5	4.7	5.0	*4.7*	*4.4*
Contributions to real GDP growth:						
- Final domestic demand	-2.3	1.2	1.3	1.4	*1.4*	*1.3*
- Change in inventories	-0.1	0.0	0.0	0.0	*0.0*	*-0.1*
- Net exports	1.0	-0.3	0.0	0.3	*-0.3*	*0.2*
Output gap1	-6.4	-5.0	-3.4	-1.6	*-5.0*	*-3.5*
Employment (% change)	-2.9	1.6	0.8	0.8	*1.4*	*1.0*
Unemployment rate (%)	16.4	14.5	13.6	12.8	*14.2*	*13.4*
Labour productivity (% change)	1.6	-0.7	0.5	0.9	*-0.4*	*0.5*
HICP inflation (%)	0.4	0.0	0.6	0.9	*0.0*	*0.7*
GDP deflator (% change)	2.3	1.1	1.4	1.5	*1.4*	*1.5*
Comp. of employees (per head, % change)	3.5	-0.4	0.9	0.9	*-0.7*	*1.2*
Current external balance (% of GDP)	-0.3	-0.2	0.1	0.3	*0.3*	*0.3*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.3	1.4	1.7	1.9	*1.5*	*1.5*

(1) In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.
Source: Commission services; DBP 2015

expected on the basis of the historical relationship between unemployment and GDP. This suggests that specific factors have played a role, such as the adjustment in real wages that occurred in recent years, a decline in the labour force and the reinforcement of ALMPs. However, unemployment remains high and a sustainable recovery of employment requires stronger GDP growth, a further reallocation of workers towards the tradable sector and employment creation based on permanent contracts.

Persistent labour market slack and falling import prices are exerting downward pressure on prices. In October, annual HICP inflation inched up to 0.1% from 0.0% in September, while the HICP 12-month average rate remained at -0.1%. Some further price acceleration due to the increase in minimum wages and cyclical rebound in private consumption can be expected towards the end of this year. However, consumer prices are projected to stay flat on average in 2014. Still high unemployment and subdued domestic demand are forecast to contain price pressures in 2015-16.

The Commission Autumn Forecast is less optimistic than the macroeconomic scenario underpinning Portugal's Draft Budgetary Plan (DBP) 2015. While headline growth figures do not differ markedly in both forecasts (Table 2.1), there are notable differences in the projected composition of domestic demand with the Commission expecting weaker private consumption and stronger fixed investment growth, not least on the back of weaker employment growth in 2015.

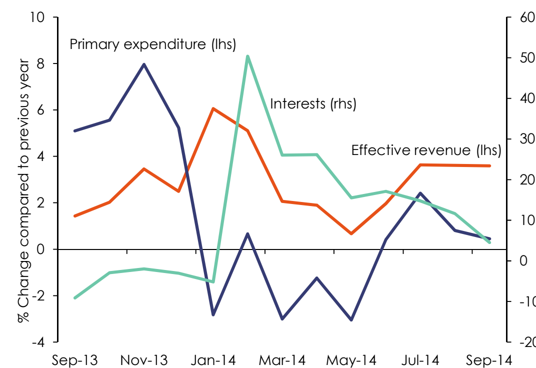
Risks to the macroeconomic outlook are tilted to the downside. Better-than-expected employment data for the third quarter indicate some upside risks for the projected labour market trends. However, the risks to the Commission 2014 Autumn Forecast remain tilted to the downside. Portugal's export performance is still heavily dependent on the economic environment in Europe, which is set to be weak in the short term. The private sector is highly indebted and continued deleveraging pressures on households and non-financial corporations could further dampen the recovery of domestic demand. Sovereign bond

yields are currently relatively low, but the reversal of global monetary policy trends or a perceived weakening of structural reform and fiscal consolidation efforts could exert upward pressure on risk premia.

Public Finance

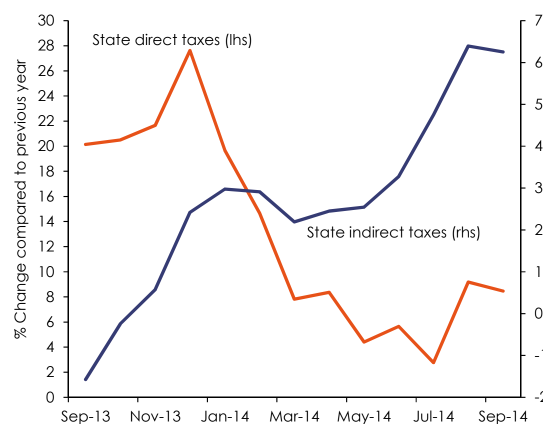
In cash terms, budget execution through end-September 2014 was in line with the second Supplementary Budget. Up to September, the general government cash balance improved by EUR 1.4 billion relative to the same period last year, in line with the intra-annual pattern of fiscal consolidation in cash terms. The cash primary balance of public administrations recorded a surplus of EUR 1.4 billion up to September. Budget execution continues to be marked by strong revenue performance, especially for indirect taxes and social contributions. This outturn is due to tax-rich economic recovery and the ongoing improvement of the labour market. Revenue growth also reflects the impact of anti-fraud actions mainly introduced in the past, such as the e-invoice reform and the unified monthly returns, from which the budget execution is still benefitting. Revenue growth is particularly remarkable for personal income tax (PIT), car tax (boosted by a pick-up in car sales) and VAT. However, the year-on-year improvement in VAT revenues is influenced by the base effect of the fairly high level of refunds in 2013 and the underlying growth in VAT revenue is much weaker. Transfers and compensation of employees explain the year-on-year growth of central government expenditure. The Social Security balance has improved with respect to the same period last year, on the back of continued improved collection of social contributions and reduced payments for unemployment benefits. Abstracting from one-off factors, the cash balance of the Region of Madeira has deteriorated, mainly due to expenditure growth associated with transport PPP and interest payments. The overall cash balance of local governments has improved relative to last year, mainly due to expenditure control and despite some revenue falls.

Graph 2.3: General Government consolidated accounts (cash data)



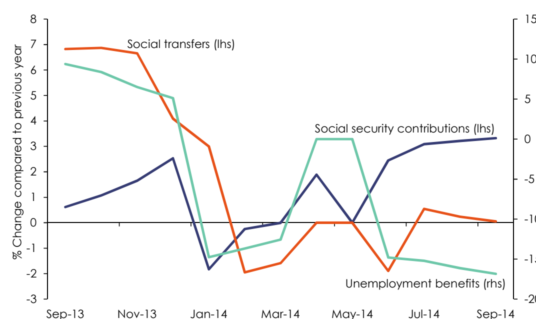
Source: DGO; Commission services

Graph 2.4: State budget execution: Revenue (cash-data)



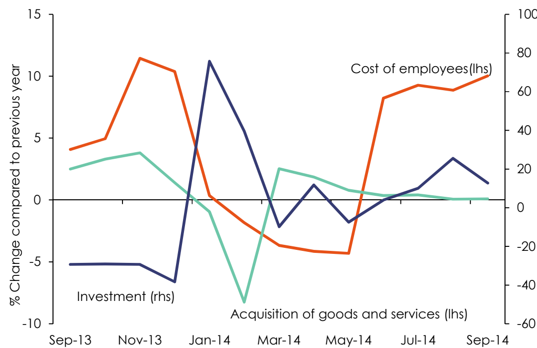
Source: DGO; Commission services

Graph 2.5: Budgetary outturn for Social Security (cash-data)



Source: DGO; Commission services

Graph 2.6: Central administration budget execution (cash-data)



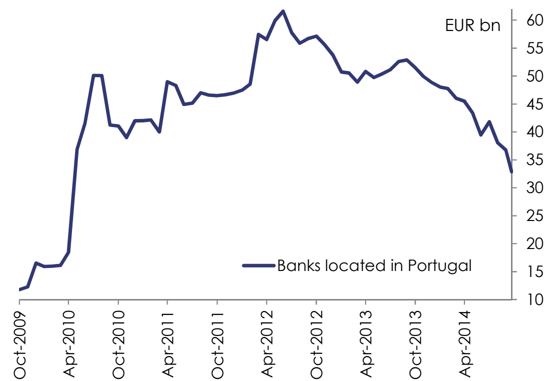
Source: DGO; Commission services

The accumulation of arrears stopped in September, but the reduction of the high stock of arrears has not yet started. Public sector arrears were reduced by EUR 44 million in September, though since the beginning of the year the balance still showed arrears accumulation by about EUR 58 million, mainly incurred by SOEs (in particular hospitals). To fund the financing needs of the relevant state-owned hospitals, the Government started the disbursement of additional resources (budgeted for up to EUR 300 million in 2014), which should help in arresting the accumulation of new arrears. This is in contrast with the developments at local and regional level, where not only new arrears have been halted but their stock is also being reduced. Overall, the outstanding stock of arrears at around EUR 2 billion or 1.2% of GDP remains elevated and further efforts are needed to achieve its full clearance.

Financial stability

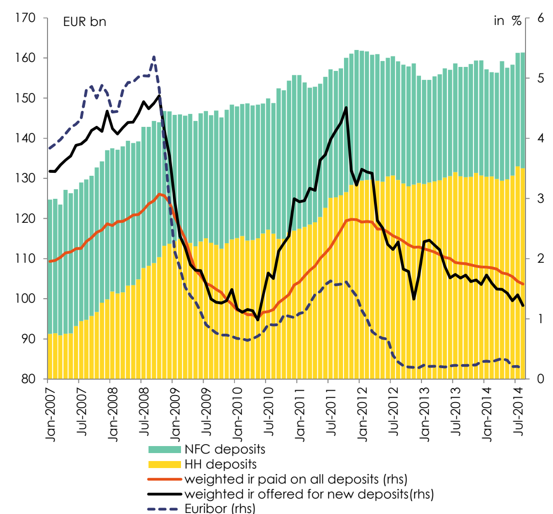
Banks are further deleveraging amid improving liquidity conditions. In 2014, three banks issued bonds in an aggregate amount of EUR 2.5 billion. Three lenders successfully managed to raise equity, either through private placements or directly in the capital market. Borrowing from the Eurosystem continues its decreasing trend, having diminished by a quarter since April 2014 (Graph 2.7). The banking system's ECB-mobilised collateral pool decreased, but at a slower pace. This has led to an overall higher collateral buffer (64% by end October). The aggregate loan-to-deposit ratio fell to 114%, which is below Banco de Portugal's recommended maximum level of 120%. The resolution of Banco Espirito Santo triggered some deposit migration within the system. By end-August, aggregate deposits grew by 2.3% y-o-y, close to its historic maximum in December 2011 and despite the lowest remuneration offered in 4 years (Graph 2.8). Corporate deposits, which comprise one fifth of the aggregate, grew by 5.8%; whereas household deposits increased by 1.5% since August 2013.

Graph 2.7: Banks are repaying the ECB



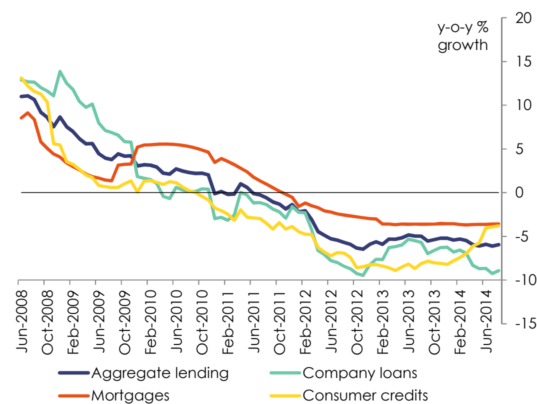
Source: Banco de Portugal

Graph 2.8: Deposits grow near to all-time highs despite falling remuneration



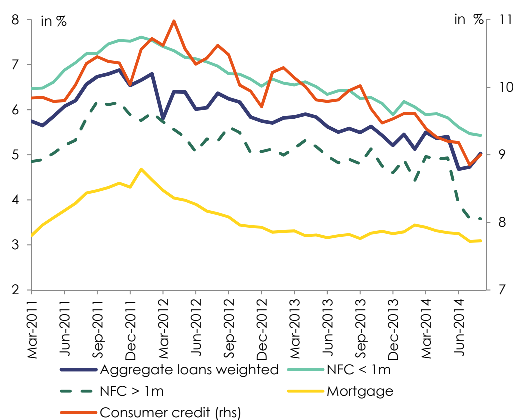
Source: Banco de Portugal

Graph 2.9: Deleveraging speed per loan segment



Source: Banco de Portugal

Graph 2.10: Interests keep falling across loan segments



Source: Banco de Portugal

The value of banks' total assets declined by 2.4% in the first half of 2014. Mortgages, consumer credit and corporate loans fell by 4%, 6%, and 8%, respectively, in the first semester of 2014 (Graph 2.9). Credit sales and write-offs accounted for a significant proportion of the decline in corporate loans, as banks sold roughly EUR 3 billion between July 2013 and June 2014 (3% of the total loan portfolio). Compared to more than EUR 100 billion in mortgages issued by Portuguese banks between 2003 and 2008, EUR 30 billion between January 2009 and August 2014 illustrate the magnitude of the fall in mortgage issuance. Since the fourth quarter of 2011, the banks' mortgage portfolio has been shrinking at an ever faster rate, as the older loan cohorts' rising redemption share is outweighing the very small amount of newly-granted mortgages. Company loans typically roll over faster than longer-term oriented mortgages, hence the decline in that part of the loan book is much faster when redemptions exceed new business. Over the past year, more than half of all newly granted loans were absorbed by large companies borrowing on average over EUR 1 million. A third went to smaller firms borrowing below that threshold. Consumer loans are gradually stabilising.

Banks' capacity to absorb losses was progressively reinforced under the programme. The aggregate Common Equity Tier 1 (CET 1) ratio of the Portuguese banking sector was 10.6% by end-June 2014, compared to a regulatory minimum of 7% and 11.1% reported at end-March 2014 (Table 2.2). The large capital shortfall reported by BES at end-June had a considerable impact on the average CET1 ratio. The loss-absorption capacity of the system was supported by stricter provisioning requirements, higher regulatory capital thresholds and continued balance sheet deleveraging – most of it initiated under the financial assistance programme, yet vulnerabilities remain. In addition, growth prospects for the Portuguese economy allowed banks to raise capital from private sources throughout 2012-2013 and in the first half of 2014. Going forward, the special regime applicable to deferred tax assets (DTA) that entered into force at the end of August is expected to have a strong positive impact on the capital ratios of some Portuguese lenders. The DTA regime follows the entry into force of the CRDIV/CRR ([1]) and is related to the reinforcements of the prudential requirements for credit institutions. The new regime was taken into account in the context of the Single Supervisory Mechanism (SSM) Comprehensive Assessment.

Internal capital generation amid low profitability remains the biggest challenge for the Portuguese banking sector. While most lenders still expect to end 2014 with a loss, transformation and cost saving measures from the past few years are expected to yield positive results going forward. Excluding the impact of the BES loss, the banking system's profitability was positive in the first half of 2014, although at a low level. Whereas banking sector (excluding BES)

([1]) Capital Requirements Directive IV / Capital Requirements Regulation.

Table 2.2: **Financial stability ratios**

%	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Return on Equity (1)	4.5	2.5	-3.8	6.3	0.9	-0.3	-4.1	-3.8	-7.1	-6.7	-10.3	-1.4	-21.8
Gross Income on Assets	2.5	2.5	2.5	2.6	2.7	2.6	2.5	2.1	2.1	2.1	2.1	2.5	2.2
Cost to Income Ratio	58.3	59.0	61.5	56.2	53.0	56.5	58.8	67.1	68.8	69.7	71.5	58.4	65.8
Non-Performing Loans	6.4	7.3	7.7	8.3	9.5	9.8	9.7	10.3	10.4	11.1	10.6	10.8	11.2
Coverage Ratio	55.7	52.7	54.6	51.6	49.6	50.5	54.3	53.9	53.9	52.9	56.4	57.6	56.1
Capital Adequacy Ratio (2)	11.0	10.2	10.7	10.7	12.3	12.3	12.6	13.0	13.1	13.4	13.3	12.4	11.9
Core Tier 1 Ratio (3)	8.7	8.5	9.6	9.6	11.2	11.3	11.5	11.9	11.9	12.2	12.3	11.1	10.6
Loan-to-deposit ratio	149.7	146.2	140.2	136.9	136.4	133.3	127.9	124.0	122.6	120.8	117.0	117.2	113.9

(1) Income before minority interests/ Average shareholders' equity before minority interests
(2) Excluding the banks in resolution
(3) The Core Tier 1 ratio according to Programme definition up to 2013Q4 and Common Equity Tier 1 ratio afterwards; excluding the banks in resolution.
Source: Banco de Portugal

return on assets (ROA) and return on equity (ROE) were around 0.25% and close to 3.8% respectively, a significant number of banks continue to record net losses or profits close to nil. Profits are not expected to recover nor are non-performing loans ratios (NPL) expected to substantially decline until a robust recovery of the economy materialises. In particular, asset quality deterioration remains a problem, with high impairment levels of about 6% of total gross loans, NPLs still at elevated levels (11.2%), especially in the corporate segment (>16%). Banks could increase their arrears resolution capacity in order to tackle elevated level of non-performing loans.

3. POLICY ISSUES

Public Finance

The Commission Autumn Forecast predicts a general government headline deficit of 4.9% of GDP in 2014 (pending the statistical treatment of the BES resolution operation) and 3.9% of GDP without one-offs. The 4.9% of GDP deficit forecast includes one-off costs of financing operations to transport SOEs and the write-off of non-performing loans of BPN Credito. The budgetary impact of the resolution of Banco Espírito Santo/Novo Banco, still under statistical analysis and amounting to 2.8% of GDP, could push the headline deficit up to 7.7% of GDP, if the subscription of Novo Banco shares by the Resolution Fund is considered to be above the line. The deficit without one-offs is forecast at 3.9% of GDP and the change in the structural balance at about 0.6% of GDP. The Commission Autumn Forecast is slightly less optimistic than the authorities' forecast for 2014 as presented in their 2015 draft budget, which projects a deficit of 4.8% of GDP (3.7% of GDP excluding one-offs). The difference is mainly due to somewhat more cautious assumptions about revenue collection and the effectiveness of some consolidation measures.

Following the end of the programme and successive Constitutional Court (CC) rulings on several 2014 budget measures and 2015 budgetary plans, the government appears to have changed its budgetary strategy. Of the expenditure measures ruled unconstitutional, 0.3% of GDP worth of measures have not been replaced in 2014. Instead, the second Supplementary Budget 2014, in force since October, compensated the remaining fiscal gap resulting from the Court rulings and from higher pressures on various expenditure items by the expected higher fiscal impact of macroeconomic revisions, the upward revision of tax collection resulting from a more efficient fight against tax fraud and the use of budgetary reserves.

In 2014, the fiscal adjustment has been progressively reduced and is now deemed to be of lower quality than the initial plans for several reasons:

- The consolidation strategy is now less based on durable expenditure compression and relies more on projected macro-related revenue performance, therefore the structural improvement is more limited.

- While increased revenue from fighting fraud can be considered structural under certain conditions, this and the extra-revenue related to the economic recovery are now used to support higher public expenditure, rather than further reducing the deficit and the debt.

- This strategy also departs from the authorities' commitment made during the programme to implement compensatory measures of equivalent size and quality should legal or execution risks to the fiscal target materialise after CC rulings.

- Finally, the amount of discretionary measures underpinning the budgetary targets for 2014 has been significantly reduced over time from 2.3% of GDP planned at the time of the 2014 budget to about 1.5% of GDP in the projection underlying the 2015 Budget.

The Government's draft budget for 2015 projects a general government deficit of 2.7% of GDP. This exceeds the 2.5% target agreed under the economic adjustment programme and recommended by the European Council under the Excessive Deficit Procedure. The Government plans to reach its 2.7% of GDP target partly by relatively high expected revenue growth, mainly indirect taxes and actual social contributions, which in turn is explained by macroeconomic developments and further efficiency gains in tax collection. In addition, the draft budget contains a consolidation package amounting to 0.7% of GDP, according to the Government's own estimates. At the same time, most expenditure items have been increased relative to their expected outturn in 2014.

According to the Commission Autumn Forecast, plans included in the 2015 draft budget are not sufficient to reach the 2.7% of GDP target and would instead lead to a deficit of 3.3% of GDP. This is consistent with the deterioration of the structural balance by 0.3% of GDP next year and a cumulative structural effort of 0.6 over the period 2013-15 (for a detailed discussion of the drivers of the structural effort estimates see Box 2). The significant discrepancy

Table 3.1: **Fiscal adjustment 2010-2015**

	2010	2011	2012	2013	2014	2015
Balance - EDP	-9.8	-7.4	-5.5	-4.9	-4.9	-3.3
Budget deficit, net of one-offs	-9.2	-7.2	-5.4	-5.2	-3.9	-3.4
Structural balance	-8.5	-5.4	-2.3	-1.9	-1.3	-1.7
Primary balance	-7.0	-3.0	-0.6	0.1	0.1	1.6
Structural primary balance	-4.6	-1.1	2.6	3.0	3.7	3.3
Fiscal adjustment	0.4	3.5	3.7	0.4	0.6	-0.4
Fiscal effort (EDP definition)	0.4	2.1	3.1	0.4	0.6	-0.3

(1) Fiscal adjustment is measured as the change in the structural primary balance; fiscal effort defined as the change in the structural balance.
Source: Commission services

between the two assessments is the result of various factors. In particular:

- Starting point: the 2015 draft budget builds on a baseline carried forward from 2014 which is slightly more favourable than the baseline in the Commission's assessment (see above).

- Consolidation measures: various consolidation measures included in the 2015 package are subject to implementation risks and may suffer delays or changes in their design, which could eventually reduce their overall yield for the budget. This is in particular the case of measures that in the past repeatedly failed to become operational or to materialise in time, such as sales of concessions, the requalification programme and the cap on social benefits. Therefore the Commission has re-assessed the yield of the package at 0.6% of GDP, i.e. 0.1% of GDP below the Government's estimates (see below).

- Different assumptions about macroeconomic developments and their impact on the budget: in particular the 2015 draft budget projects fairly high revenue growth, explained by a growth composition increasingly driven by domestic demand and by a generous impact of intensified measures to fight fraud and evasion. ([2]) The Commission Autumn Forecast concurs with the authorities' assessment on the sources of revenue growth. However, the Commission forecast is more conservative and assumes a smaller impact from all these factors on the budget by about 0.4% of GDP altogether. First, the macro-economic outlook by the Commission is less optimistic, which implies a lower cyclical revenue growth. Second, while the Commission Autumn Forecast acknowledges the increased efficiency of revenue collection in past years by fully carrying forward the improved revenue performance, it is more prudent in the ex-ante estimate of additional yields from anti-fraud measures in 2015.

The permanent consolidation measures included in the 2015 draft budget are about equally distributed between revenue increases and expenditure cuts. The package includes the budgetary impact in 2015 of two measures already adopted in 2014, but which will take effect only later in the year: the increased beneficiaries' contributions to the public sector's health systems and the mutual agreement terminations of public employment contracts (0.1% of GDP carry-over effect in 2015 altogether). The remaining measures include, from the expenditure side: savings from public employment reductions, planned to be attained mainly by attrition, non-renewal of some contracts in areas with over-employment and the requalification scheme; a further re-organisation and streamlining of state-owned enterprises; expenditure cuts across line ministries; the rationalisation of ICT-related costs and of contracted studies, consulting and other projects; a newly planned cap on total social subsidies received by an individual and a solidarity contribution from the highest pensions. On the revenue side, discretionary measures include increases in excise duties and other minor revenues (from online gambling and increased bank levy), increased savings from the health sector through a claw-back tax on health-impacting industries and higher contributions to road services. The

([2]) The Government's draft budget does not present the impact of fight against tax fraud and evasion separately as part of the measures but implicit in the macroeconomic developments.

Box 3.1: Impact of methodological and statistical changes on the estimated structural effort

This box discusses the reasons for the recent significant deterioration in the estimated structural fiscal effort in Portugal by trying to disentangle the impact of effective changes in fiscal policy, which this indicator is meant to capture, from the impact of the methodological and statistical changes introduced in 2014. In particular, statistical and methodological changes concerned a) the revision of the methodology to calculate the structural unemployment (NAWRU) for potential growth, with an impact on the output gap, in spring 2014; b) the revision of the OECD semi-elasticities in autumn 2014; and c) the introduction of the new national accounting standards ESA-2010, which led to a substantial revision of both macro-economic as well as fiscal indicators in Portugal as from 1995. The main finding of the analysis is that statistical and methodological changes introduced in 2014 had a significant negative impact on the cumulative structural effort over 2013-15. However, the largest impact concerns the annual structural effort of 2013 while the impact on 2014 and 2015 is much smaller. The deterioration of the structural balance in 2015 is predominantly driven by the fading fiscal consolidation effort of the government.

Under the European fiscal rules framework, the fiscal consolidation effort of a Member State is captured by the change in the structural balance and is thereby a key indicator in assessing compliance with obligations under the Stability and Growth Pact. The structural effort is calculated as the general government balance net of one-off measures adjusted for the impact of the economic cycle. The impact of the cycle in turn is calculated by applying OECD semi-elasticities to the output gap estimated on the basis of the commonly agreed methodology.[1] While the estimated structural effort can – and usually does – change after the regular revisions of macroeconomic or fiscal forecasts, the methodological and statistical changes introduced this year have each affected the estimated structural effort in addition to the regular revisions.

Table I. Evolution of general government balance and structural effort projections

		(1)	(2)	(3)	(4)
GG balance	2013 CR (June 2013)	11R (April 2014)	PIR (Oct 2014)	2014AF (Nov 2014)	2014 AF (2.5)
2012		-6.4	-6.4	-5.5	-5.5
2013	-5.5	-4.9	-4.9	-4.9	-4.9
2014	-4.0	-4.0	-7.1	-4.9	-4.9
2015	-2.5	-2.5	-2.5	-3.3	-2.5
GG balance net of one-offs	2013 CR (June 2013)	11R (April 2014)	PIR (Oct 2014)	2014AF (Nov 2014)	2014 AF (2.5)
2012		-5.8	-5.8	-5.4	-5.4
2013	NA	-5.2	-5.3	-5.2	-5.2
2014	NA	-4.0	-4.0	-3.9	-3.9
2015	NA	-2.5	-2.6	-3.4	-2.6
Structural Effort	2013 CR (June 2013)	11R (April 2014)	PIR (Oct 2014)	2014AF (Nov 2014)	2014 AF (2.5)
2013	0.6	1.0	0.9	0.4	0.4
2014	1.4	0.5	0.6	0.6	0.6
2015	0.5	0.9	0.7	-0.3	0.5
Cumulative Structural Effort	2013 CR (June 2013)	11R (April 2014)	PIR (Oct 2014)	2014AF (Nov 2014)	2014 AF (2.5)
2013	0.6	1.0	0.9	0.4	0.4
2014	2.0	1.5	1.5	1.0	1.0
2015	2.5	2.4	2.1	0.6	1.5

Note: 2013 CR: Council recommendation to Portugal under the Excessive Deficit Procedure; 11R: eleventh Programme review scenario; PIR: Programme Implementation Report, European Economy Occasional Paper 202, Oct 2014. 2014 GG balance excluding BES recapitalisation (2.9% of GDP), so as to make it comparable with the 2014AF GG balance; 2014AF: autumn 2014 European Economic Forecast; 2014AF (2.5): hypothetical scenario with the 2014 AF up to 2014 and assuming that the 2015 headline deficit reaches the Programme and the EDP headline deficit target of 2.5% of GDP.

Source: Commission services

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[1] See e.g. D'Auria et al.: The production function methodology for calculating potential growth rates and output gaps, (European Economy Economic Papers Nr. 420, July 2010) and Mourre et al.: The cyclically-adjusted budget balance used in the EU fiscal framework: an update (European Economy Economic Papers Nr. 478, March 2013)

(Continued on the next page)

Box (continued)

In the course of 2014, Portugal's estimated structural effort over 2013-15 has changed significantly since the 11th programme review forecast (11R) (see Table I). The 11R forecast is chosen as the starting point as this was the first fiscal forecast in 2014 based on the 2013 outturn data while at the same time the output gap methodology and the semi-elasticity were not yet revised and ESA-95 was still the accounting standards (see table II). The total change in the structural effort between the 11R and the 2014 autumn forecast (2014AF) is decomposed into changes driven by fiscal policy and changes driven by methodological and statistical revisions (for the sake of simplicity, we abstract from the impact of macro-economic revisions on the estimated structural effort, which can be considered relatively small over the period). The impact of changes in fiscal policy can be disentangled from the impact of the methodological and statistical changes by comparing various hypothetical calculations of the structural effort. In particular, the structural effort has been recalculated a) for each fiscal forecast vintage keeping the output gap and the semi-elasticity constant; b) for each output gap vintage keeping the fiscal forecast and the semi-elasticity constant and c) for each forecast vintage using old and new OECD semi-elasticities.

Table II. Methodology and accounting standards applied in different forecasts

Applied methodology	2013 CR (June 2013)	11R (April 2014)	PIR (Oct 2014)	2014AF (Nov 2014)	2014 AF (2.5)
output gap	old	old	new	new	new
semi-elasticity	old	old	new	new	new
accounting standards	ESA-95	ESA-95	ESA-95	ESA-2010	ESA-2010

Source: Commission services

The impact of fiscal policy was defined as the sum of the change in the structural effort between the fiscal forecast of the Programme Implementation Report (PIR scenario) and of the 11R keeping the output gaps and semi-elasticity constant, plus the difference in structural effort between the 2014 autumn fiscal forecast and the hypothetical 2014 autumn fiscal forecast which keeps the 2015 deficit at the 2.5% of GDP target (2014 AF (2.5)). All remaining changes were attributed to methodological and statistical changes and are equivalent to the sum of a) the difference in structural effort between the PIR scenario and the 11R not attributed to policy changes (which captures the impact of the change in the output gap methodology and the new semi-elasticity); and b) the difference in the structural effort between the hypothetical 2014 autumn fiscal forecast and the PIR scenario (which captures the impact of ESA 2010, both on fiscal and on macroeconomic data).

Table III. Structural effort revisions 2013-15

Structural Effort	Total revisions 11R - 2014 AF	Impact of fiscal policy changes	Impact of methodological / statistical changes	*Of which impact of ESA2010 only*
2013	-0.6	0.0	-0.6	*-0.5*
2014	0.1	0.1	0.0	*0.0*
2015	-1.2	-1.0	-0.2	*-0.2*
Cumulative Structural Effort	Total revisions 11R - 2014 AF	Impact of fiscal policy changes	Impact of methodological / statistical changes	*Of which impact of ESA2010 only*
2013	-0.6	0.0	-0.6	*-0.5*
2014	-0.5	0.1	-0.6	*-0.5*
2015	-1.7	-0.9	-0.8	*-0.6*

Source: Commission services

Table III summarises the results. The estimated cumulative structural effort has dropped by 1.7% of GDP since the 11th programme review, of which 0.8% of GDP can be attributed to various methodological and statistical changes, and with ESA-2010 alone accounting for a reduction by 0.6% of GDP. The remaining reduction of about 0.9% of GDP is driven by changes in fiscal policy. It is striking that the negative impact

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Box (continued)

of the methodological and statistical changes is mostly concentrated in the reduction of the 2013 annual structural effort which is largely due to the fact that the introduction of ESA-2010 has led to a significant downward revision of the 2012 headline deficit (including and excluding one-offs), which is the basis for the calculation of the 2013 structural effort. In contrast, the large drop in the estimated 2015 annual structural effort between the 11R and the 2014 autumn forecast is predominantly attributable to the lower fiscal consolidation effort of the government. It is also worth noting that, had the government implemented in the 2015 Budget permanent measures consistent with the achievement of a 2.5% of GDP deficit target as recommended, the 2015 annual structural effort could have reached 0.5% of GDP, in line with the Council Recommendation to Portugal.

consolidation package also includes one-off measures which the Government estimates to be worth 0.1% of GDP.

Some of these consolidation measures are the continuation of reforms that took place during the economic adjustment programme. These measures concern among others the targeted public employment reductions, restructuring of SOEs and the health sector, and are considered consistent with the objective of rationalisation and improved efficiency of the public sector.

At the same time, the 2015 draft budget confirms the reversal of some measures that significantly contributed to consolidation in the last years. This notably affects the reinstatement of 20% of the cuts in public employees' compensation as well as the abolition of the extraordinary solidarity contribution on pensions (CES), as already announced in the Fiscal Strategy Document. These were meant to be temporary consolidation measures in the last years, to be replaced by durable structural measures in the same areas. The draft budget does, however, not indicate possible avenues to contain the wage bill in a durable manner, nor does it present new comprehensive measures for improving the medium-term sustainability of the pension system.

The debt-to-GDP ratio reached 128.0% at the end of 2013, and is set to start declining in the second half of this year. The economic recovery as well as the use of accumulated cash reserves and other debt-reducing operations should underpin the downward trend of the debt-to-GDP ratio, which is forecast to reach 127.7% of GDP by the end of 2014 and 125.1% of GDP by the end of 2015. The ratio could remain on a sustained downward path in the future, if supported by a sufficiently high primary budgetary surplus as well as by nominal GDP growth (see Annex 2 on debt sustainability analysis).

Risks to the fiscal projections are tilted to the downside. For 2014, the one-off operation related to Banco Espírito Santo could be accounted as deficit-increasing by statistical authorities. For 2015, taking into account latest information, fiscal risks related to the economic outlook have become more balanced. Nevertheless, significant downside risks remain related to the projected improvement in the efficiency of revenue collection. In addition, risks also relate to the possible underperformance of some further consolidation measures which have not been discounted in the Commission forecast (e.g. savings on ICT); and new pressures to the execution of the budget arising during the year, in particular to expenditure ceilings, as it has been the case in past years. Moreover, the 2015 budget intends to use potential extra VAT and PIT revenues for the reimbursement of the PIT surcharge, which precludes the use of potentially arising buffers to reduce the deficit.

The announced tax policies imply slight growth-friendly tax shifts in the composition of total revenue. In particular, the draft budget envisages the continuation of the corporate income tax reform initiated in 2014 by further reducing the standard rate by 2pp (reform not quantified as a separate measure in the budget), as well as further revenue from property taxation. The ongoing reform of the personal income tax (PIT) aims at a more family-friendly tax system, social mobility promotion and simplification of the tax structure, with its budgetary implications depending on its final design. In parallel, the green tax reform aims at contributing to a more sustainable economic

development model and allows shifting taxation away from income. These reforms constitute growth-friendly tax shifts, although their effects on employment and growth have not been quantified. According to the draft budget, the temporary 3.5% PIT surcharge will be maintained, but it foresees a tax credit that could potentially be used against this surcharge in the 2016 tax assessments, should the 2015 effective revenue from PIT and VAT over-perform initial estimates. While the promise of financing tax reductions from additional revenue can create incentives to improve tax compliance, the strategy ties the government's hands not to use any potential additional revenue from these taxes for possible expenditure slippages (as it was the case in the past) or for further deficit reductions.

Fiscal-structural issues

Building on successful Public Financial Management (PFM) reforms, the comprehensive reform of the Budget Framework Law (BFL) needs to be concluded and implemented. Notably, the broad-based BFL reform should be concluded by end-2014, providing the basis for sounder fiscal management and sending a strong signal of commitment to fiscal discipline. The technical group charged with the revisions of the BFL is to present reform proposals by end-November. The reforms are based on an analysis of outstanding fragilities in the system and recommendations by relevant stakeholders. In particular, they should streamline budget appropriations, reduce the still high budget fragmentation, strengthen accountability of the different budget units, improve the budgetary cycle calendar and strengthen the medium to long-term focus of public finances, including a stricter definition of expenditure ceilings. When the legislative reform is completed, the focus should move to the implementation phase under strong leadership of the Ministry of Finance.

Efforts continue to improve the accounting and reporting framework. The October 2014 IMF Fiscal Transparency Evaluation pointed at further challenges to meet advanced levels of fiscal transparency and suggested a further strengthening of the PFM. The Ministry of Finance and the standard setting body are working on the preparation of a new public-sector accounting framework, based on internationally accepted standards. Following public consultation, the plan is to submit the project for Government approval and prepare the implementation manual in 2015, while practical implementation for all entities will extend into 2017.

The implementation of the Commitment Control Law (CCL) is being assessed and areas for improvement identified. Progress in the implementation of the CCL is being monitored by a dedicated Working Group within the Ministry of Finance. The CCL has helped to address the accumulation of arrears in different subsectors of the public administration, by improving discipline and budgetary control of the entities. However, there are still limitations to its implementation and its underlying principles are not yet fully enforced. The necessary reforms should be taken forward to prevent any new accumulation of arrears.

Given the high reliance of revenue projections on yields from the fight against tax fraud and evasion, a strong implementation of anti-fraud actions is a top priority. The 2015 draft budget announces measures to reinforce efficiency in curbing tax fraud and evasion, including the development of a new Strategic Plan 2015-2017 and reinforcement of the Large Taxpayer Office's resources and competences. The mission was also informed of the planned measures against fraud, tax evasion and the shadow economy to be implemented by the Portuguese tax administration. These measures mainly imply further exploiting the potential of e-invoicing and the unified monthly returns, by strengthening existing procedures and better cross-checking all relevant information. In a number of cases, the proposed changes suggest a more automatized control (e.g. for pre-calculation of tax reimbursements) or a broader control, notably, extending the reach of strengthened control to more State taxes and to more taxpayers. Some measures are new (e.g., the mandatory communication of inventories for taxpayers with turnover above EUR 100,000) and can be fairly effective, especially if targeted to sectors in which fraud is prevalent (e.g. control of certain deductions in PIT). Other measures aim at tackling fraud in the rental market, where the share of the shadow economy is of particular concern, but these measures lack clear specification. Overall, for the plan to be effective in yielding additional revenue, critical capacity must be developed within the tax administration to handle the vast amount of relevant data gathered through

the e-invoice system. In addition, the incremental effect of anti-fraud measures on revenue in the short term has to be treated with caution, as possible lags between implementation and results may occur, since the latter also relies on behavioural changes which may take some time to materialise.

The successful reform agenda of the revenue administration needs to continue and more needs to be done to strengthen taxpayer compliance. Organisational reforms are ongoing in the tax administration, for example with the planned integration of local tax offices into the Aproximar programme, the steps forward of the Risk Management Unit and the recently created Taxpayers' Services Department. Yet, there is ample scope for further reforms to modernise the revenue administration and further strengthen taxpayer compliance. These include, in particular, more efforts to fight the shadow economy, combatting tax fraud in the housing market, improving information-sharing arrangements with financial institutions and strengthening the anti-money-laundering framework.

The operating balance of SOEs improved considerably despite headwinds. Since the beginning of the programme, authorities have engaged in a comprehensive restructuring of SOEs. In 2013, the overall net income of non-financial SOEs improved by EUR 1 billion and turned positive, benefiting from better operating performance and improved financial results. Operating costs continued to decline throughout the first half of 2014. The transport sector made further progress in staff reduction. The merger between EP/REFER continues as planned, with overall net savings expected to exceed EUR 1 billion in a 5-year period starting in 2015, and the restructuring of Águas de Portugal (AdP) is also progressing. With the new legal regime for SOEs in place since December 2013, the shareholder's role is now with the Ministry of Finance, supported by the new technical unit UTAM. Delays in quarterly and yearly reporting are expected to be fully addressed from the beginning of 2015.

Privatisation efforts continue, with total proceeds now above EUR 9 billion, way beyond the EUR 5.5 billion target set under the programme. The remaining 31.5% of outstanding shares of the postal company CTT were sold in September. The waste management holding (EGF)'s sale contract was signed on 6 November, but full payment is still awaiting the Competition Authority's green light for the sale. The national air carrier TAP is again available for privatisation, after the 13 November Council of Ministers' decision to re-launch the process. Several other SOEs are still in the pipeline for privatisation, including the freight railway operator CP Carga, the sightseeing bus operator Carristur, and the maintenance and development of trains company EMEF. Regarding the sale of the silage terminal concession belonging to Silopor, which was launched in 2007 and cancelled in 2014 due to provisional award expiring, the Government is now assessing how to re-launch its sale.

The renegotiation of several PPPs remains to be concluded. The renegotiation of the road PPPs' ex-SCUTs+2 package is progressing and first savings of EUR 140 million materialised already in 2013. Notwithstanding the delays in lending banks giving a waiver to each renegotiated contract, the authorities remain committed to finalising the bulk of the renegotiation of road contract PPPs with all concessionaires in 2014, generating additional structural savings of more than EUR 6 billion over the life cycle of these concessions. The renegotiation of the emergency and security sector PPP (SIRESP) continues as planned, aiming at concluding the process by the end of the year. The studies on the two potential new PPPs in the health sector (HLO – Hospital de Lisboa Oriental and CMFRS – Centro de Medicina Física e de Reabilitação do Sul) are on schedule.

The implementation of public administration reforms is proceeding, but at a slower pace and with less budgetary impact than initially expected. The reduction of public administration employment is foreseen to continue, in particular through extensive use of early retirement. However, the termination of fixed-term contracts, the implementation of the requalification scheme and the termination of contracts by mutual agreement are contributing much less to the employment reduction than previously planned. The implementation of the single wage-scale and the single supplement-scale in 2015 will bring more transparency and fairness to the remuneration system, but it is not expected to yield any expenditure savings.

Following the Constitutional Court ruling earlier this year, the government has abandoned its plans for an ambitious pension reform. The 2015 draft budget abolishes the temporary extraordinary solidarity contribution from pensions (CES) that was in place since 2011, except for a contribution on the highest pensions. The draft budget does not replace this measure with any other permanent measure. In addition, other plans related to pensions that had been set forth by the Pension Reform Working Group have also been put on hold or reversed. This concerns, in particular, the planned adjustment factor which should have linked pension developments to the short-run balance of the system. The freezing of early retirements in the private sector has also been partially suspended.

The regional budgets are no longer a source of concern. The Autonomous Region of Madeira continues to meet the budget targets as agreed in its adjustment programme with the Government, even though the processes of arrears settlement, PPP renegotiations, privatisation, and assets sale are delayed. If budget consolidation continues, it is reasonable to expect that Madeira's debt sustainability and access to financing will be fully restored by the end of the region's adjustment programme at end-2015. Public finances in the Autonomous Region of Azores remain sound, with a budget broadly in balance and a small debt stock.

Local administration reforms are making good progress. The local arrears strategy (PAEL) is coming to an end, as the few remaining problem cases will be taken up by the Municipality Support Fund (FAM), a debt workout mechanism for over-indebted municipalities that is currently being set up and to become operational in spring 2015. It is expected that, at this stage, 23 municipalities will be given access to the FAM under the conditions of budgetary adjustment and a renegotiation of their debt with creditors. Sanctions in the form of reduced transfers for violating debt limits and not reducing arrears have been imposed on several municipalities. A strategy ('Aproximar') with the objective of reorganising the public services network at local level is to be rolled out in 2015, starting with 57 municipalities.

The authorities presented a positive assessment of the finances of the Portuguese health system (NHS). As a result of the Constitutional Court decision on the reversal of salary cuts in the public sector, expenditure was higher than expected in 2014 and this was reflected in an additional increase of the budget by EUR 131.4 million. Hospital SOEs are being brought to operational balance in 2014 (measured by zero EBITDA). In the meantime, these SOEs have been reclassified inside the General Government perimeter under the ESA2010 rules. Arrears remain a challenge, although the authorities have been putting in place mechanisms to address it, enabling a reduction of arrears by end-2014. The budget 2015 foresees further strengthening of their balance sheet and sustainability through capital injections and by clearing old debts to the NHS's payment support fund (FASP). Nevertheless, the implementation of the NHS budget 2015 requires close monitoring to ensure that there is no accumulation of new arrears.

Momentum in implementing and proposing new measures in terms of primary care and hospital reform continues. In terms of primary care, the authorities presented a number of measures which have been implemented since 2011, as well as others planned in 2014-15. The aim to address the lack of family doctors for 14% of the population continues to be a challenge. The authorities continue to make progress on hospital reform. They have just finalised a report on the establishment of reference centres and are proceeding on the reclassification of hospitals, with the aim of finalising the reforms by June 2015. This is encouraging in an area where regional authorities have resisted such measures in the past. There has also been progress in improving the mobility of health professionals in the NHS, with the possibility of moving health professionals up to 60 km from home address without requiring consent. There is also progress on a new law enabling collection of information from the private sector, which should complement the information already held on the availability of public-sector staff for each geographical area.

Expenditure compression in medicines continues in 2015. Overall spending seems to be at 2013 levels (around 1.2% of GDP), somewhat above the target of 1% of GDP. INFARMED argued that this is an important achievement in a year where innovative new drugs have been introduced. In absence of a cost-containment agreement with the industry, the authorities are

planning to keep the claw-back in place, as well as an expenditure ceiling "towards 1% of GDP" for 2015. The generics market share in counting units has meanwhile continued to rise to 47% by July 2014, which is encouraging.

Centralised procurement continues, delivering increased savings in the NHS. Progress reported by the authorities in terms of centralised procurement of medicines, medical devices and other goods is essential for increasing the efficiency of procurement. Authorities are developing an innovative electronic platform for centralised purchasing, which will be in place by the end of 2014 and the use of which will be compulsory for all NHS.

Financial sector

The recapitalisation of Novo Banco, as part of the resolution of Banco Espírito Santo (BES), leaves the banking system potentially exposed to a contingent liability. Novo Banco was created as a bridge bank when the Banco de Portugal applied a resolution measure to BES on 3 August 2014. As part of BES's resolution, the resolution authority moved the lender's deposit-taking operations and most of its assets to Novo Banco, while all shareholders and junior bondholders exposures have been left with BES (as the "bad bank"). At the same time, Novo Banco received a EUR 4.9 billion capital injection from the Portuguese Resolution Fund, which became the bank's sole shareholder. The Resolution Fund received in turn a EUR 3.9 billion loan from the Portuguese Treasury, while the remaining one billion was financed directly by the Resolution Fund (EUR 377 mn) and jointly by the other Portuguese banks, proportionally to their asset base. Novo Banco should be sold within 24 months after the resolution. The Portuguese banking sector, as a whole, is ultimately responsible for the repayment of the Treasury loan to the Resolution Fund, which exposes Portuguese lenders to a contingent liability if the sale price is lower than the share capital initially paid in by the Resolution Fund. Novo Banco has not yet been able to publicly disclose financial information on the bank's initial balance sheet (a balance sheet audit process underway is due to be completed by end-November) or quarterly profit and loss account.

The large overhang of private debt remains a potential constraint on economic recovery. The ratio of non-financial corporate (NFC) debt relative to GDP was 184.7% in the second quarter of 2014, increasing by 1.5pp. and 4.7pp. relative to March 2014 and June 2013, respectively. Although this debt ratio has declined for micro and small corporations, larger companies appear to have used their better access to credit to increase their leverage. Considering that in parallel the overdue loans ratio of NFCs increased by 1.8pp. y-o-y in the second quarter of 2014, reaching 14.4% of total, banks could further develop their ability going forward to deal with distressed debt. The number of NFCs with overdue loans is close to 70,000, representing over 31% of the total with loans granted by the resident banks. The largest increase in the overdue loans ratio occurred in the case of real estate activities, with an increase of 1.4pp. vis-à-vis the previous quarter. By size of the company, the overdue loans ratio is the highest in the category of micro corporations (20.9%) and the lowest in the case of large companies (3.6%). Against this background, the authorities have taken steps to overhaul the corporate insolvency and restructuring framework, giving it a stronger focus on the recovery of firms rather than their liquidation. Building on the success of this new framework, the authorities should continue to improve these new procedures and address their limitations. Additional tools for identifying companies with a high probability of default and encouraging credit institutions to proactively define procedures and solutions for such companies should be further enhanced.

The European Commission has approved the creation of the Development Financial Institution (DFI). The new DFI received its financial company license from the Banco de Portugal in mid-September and was set up with an initial capital of EUR 100 million. The DFI will operate as a wholesale institution in close partnership and complementarity with the financial system and plans to be fully operational in 2015. The DFI's statute affirms that the institution, funded by the Portuguese state and European Structural and Investment Funds (ESIF), will manage holding or specialised funds and provide SMEs with access to funding on a co-investment basis with private investors. In particular, the DFI will address market failures, which hamper small and medium-sized enterprises in accessing finance

Box 3.2: The ECB's comprehensive assessment

The European Central Bank (ECB) assumed banking supervision tasks on 4 November 2014 within the Single Supervisory Mechanism (SSM). In preparation to this transition, the ECB has conducted a comprehensive assessment (CA) of 130 banks which consisted of two components:

(1) The asset quality review (AQR) was a point-in-time assessment of the accuracy of the carrying value of banks' assets as of 31 December 2013 and provided a starting point for the stress test. The AQR was undertaken by the ECB and national competent authorities (NCAs), and was based on a uniform methodology and harmonised definitions.

(2) The stress test (ST) provided a forward-looking examination of the resilience of banks' solvency to two hypothetical scenarios, also reflecting new information arising from the AQR. The ST was undertaken by the participating banks, the ECB and NCAs, in cooperation with the European Banking Authority (EBA), which also designed the methodology along with the ECB and the European Systemic Risk Board (ESRB).

Banks were required to maintain a minimum CET1 ratio of 8% under the AQR and the ST baseline scenario, and 5.5% under the ST adverse scenario. The different paths of GDP growth, unemployment, 10year government yield and residential real estate prices under both scenarios are listed in Table I.

Portugal's four biggest lenders Caixa Geral de Depósitos (CGD), Banco Comercial Português (BCP), Banco Português de Investimento (BPI) and Espírito Santo Financial Group (ESFG) have been selected for the CA but ESFG was removed from the list due to the BES resolution process. It has not been possible to include the results of the comprehensive assessment for the successor institution, Novo Banco, due to inability to conduct the exercise on time. Several other euro-area banks whose subsidiaries and branches are incorporated in Portugal also participated in the ECB assessment in their home countries.

All Portuguese banks met thresholds of the AQR and baseline scenario. The net AQR adjustments to CET1 capital for three Portugal's banks amounted to EUR 1.2 billion. Under the ST baseline scenario CET1 ratios for all three banks declined slightly. Under the ST adverse scenario, BPI's and CGD's CET1 ratios decreased by 356 bps and 432 bp, respectively, while still remaining above the threshold of 5.5% (Table II). BCP's CET1 ratio fell just below 3% and failed the ST adverse scenario. BCP has submitted a capital plan to the SSM, detailing how the shortfall will be addressed.

Table I. Financial and macroeconomic variables used for the stress test

Starting point 31/12/2013	BPI	CGD	BCP
CET 1	3,317	6,929	5,569
RWA	21,711	63,885	45,559
CET 1 in %	15.28	10.85	12.22
AQR adjustments (in)	**-26**	**-281**	**-896**
CET 1	3,291	6,651	4,667
RWA	21,710	63,870	45,502
CET 1 %	15.16	10.41	10.26
2016 Baseline outcome (CET1 minimum is 8%)			
CET 1	3,258	6,100	4,001
RWA	21,845	64,910	45,277
CET 1 %	14.91	9.40	8.84
2016 Stress scenario (CET1 minimum is 5.5%)			
CET 1	2,558	3,982	1,356
RWA	22,058	65,419	45,321
CET 1 %	11.60	6.09	2.99

Source: ECB and EBA

Table II. Stress test and baseline results

Starting point 31/12/2013	BPI	CGD	BCP
AQR adjustments (in)	-27	-281	-896
CET 1	3,291	6,651	4,667
RWA	21,710	63,870	45,502
CET 1 %	15.16	10.41	10.26
2016 Baseline outcome (CET1 minimum is 8%)			
CET 1	3,258	6,100	4,001
RWA	21,845	64,910	45,277
CET 1 %	14.91	9.40	8.84
2016 Stress scenario (CET1 minimum is 5.5%)			
CET 1	2,558	3,982	1,356
RWA	22,058	65,419	45,321
CET 1 %	11.60	6.09	2.99

Source: ECB and EBA

(both debt, equity or quasi-equity funding) without unduly distorting competition. An external analysis of market failures is currently in preparation and should become the basis for finalising the details of the DFI operations. Moreover, the DFI will manage (off-balance) and channel European Structural and Investment Funds (ESIF) allocated to Portugal for the 2014-2020 financing period, as well as reimbursements from ESIF-funded programmes.

Structural reforms

The process of structural reform has lost momentum since the end of the programme, with an uneven pace of implementation across policy areas. Progress in the post-programme period was observed in some areas, while very little progress was made in several other areas. In some cases, past achievements were attenuated.

Progress was observed in the following areas:

- **Reforms to improve educational outcomes and quality of secondary education and vocational training continue.** The scope of the existing monitoring tool has been enhanced to provide information for private schools with trust agreements and vocational and education training (VET) and Centres for Qualification and Vocational Education (CQEP) activities. Work is ongoing to improve the quality of vocational and educational training, cooperation with the business sector and knowledge transfer notably through business schools of reference and professional technical courses.

- **Portugal is now gradually implementing the remaining programme measures to address excess rents in the energy sector and to reduce the electricity tariff debt, although the envisaged medium-term tariff-debt reduction is now projected to proceed at a slower pace than anticipated.** In late April, the Portuguese authorities have presented a third package of measures aimed at tackling remaining excess rents in the energy sector, further reducing the electricity tariff debt and achieving a more balanced distribution of economic surplus between different stakeholders. The authorities are gradually making progress with the implementation of this package, with some of the higher-impact measures already approved by the Council of Ministers. Another promising policy initiative, already announced towards the end of the adjustment programme, involves price reductions for customers as a means to redistribute windfall profits gained by the provider of natural gas on take-or-pay contracts; this initiative is expected to enter the legislative pipeline before the end of the year. However, in spite of the reforms implemented, clearing the tariff debt by 2020 remains a challenge. The latest updated projections foresee that the tariff debt will peak at EUR 4.8 billion in 2015, before gradually falling to EUR 1 billion by 2020. This new estimate is about EUR 400 million higher than previous projections, with the difference mainly attributable to an increase in the fraudulent consumption of electricity in recent years. It will be of key importance that the authorities robustly address this problem as planned. [3] The authorities should also continue their efforts to identify additional measures to reduce remaining rents in the energy sector, so as to bring down the electricity tariff debt more quickly while minimising energy price increases for households and firms.

- **A new financing model for the Competition Authority is foreseen but needs to be implemented effectively.** The Competition Authority Decree Law, published in August 2014, provides the Competition Authority with a new financing model. The financing model envisages a range of contributions which seem to be below what is necessary to cover the Authority's expected costs in the medium term. The adequacy of this financing model has to be carefully monitored, with a view to underpinning future needs of the Authority and new important tasks to be performed, including a fostered advocacy capacity.

- **Measures to foster simplified administrative procedures have been taken but need to be reinforced.** Further efforts are necessary to complete the reform agenda in relation to licensing procedures, as there are still outstanding decrees, leftovers from the economic

(3) Measures already identified (but not yet taken into consideration in the tariff debt update) include: (1) revised ERSE regulation which is already under public consultation; (2) revisions to the general law on electricity theft, which currently does not consider such fraud a crime (ready by the next PPS mission), and (3) an investment plan to introduce smart meters as foreseen under the EU directives for energy efficiency (dependent on availability of funds).

adjustment programme, not yet approved mainly in the area of environmental, territorial and urban planning and land registration. In the context of the SIMPLIFICAR initiative, the authorities are implementing the road map aimed at reducing regulatory burdens. Work is ongoing, although with some delay, to further improve the business-friendliness of the regulatory environment. This work involves approval of the methodology for impact assessment of legislation, which includes the "one-in/one-out" rule as well as enlarging the scope of the existing inventory of the most burdensome regulations covering new sectors, notably tourism, construction and agriculture. To this purpose, a governance framework for regulatory simplification activities at a central level is being set up, based on inter-ministerial coordination and stakeholder engagement mechanisms. Work is also ongoing to improve the public procurement database (BASE) to correct factual entry mistakes and the Point of Single Contact to provide on-line information for businesses.

- **Progress continues in the reform of the judiciary, but closer monitoring is needed.** The introduction of the new code of civil procedure is expected to speed up the resolution of cases although due to lack of statistical data for 2014 the assessment has to be postponed. Due to modernisation of the central database for court files, CITIUS, some data are not available for 2014; it is not certain when the database will become fully operational so that it may be difficult to draw conclusions on yearly trends in 2014. The database for tax courts, SITAF, remains unreliable. Arrangements related to the physical relocations of the courts are being finalised. Evidence (including available figures for 2014) shows that the number of insolvency cases is slowly diminishing.

Very little progress was observed in the following areas:

- **The authorities need to step up efforts to evaluate the implementation of past structural reforms.** The available evidence on the impact of the programme reforms on the functioning of the economy is still scarce and their success cannot be fully ascertained. The mission found that no progress has been made to introduce systematic ex ante and ex post assessments in the legislation process and to assign the task of a systematic evaluation of reforms to a unit which enjoys some independence from the government to allow for the objectivity and credibility of assessments.

- **Reforms in the transport sector have largely come to a standstill.** One key left-over measure from the programme involves making AMT, the new transport regulatory authority, fully operational. After adopting AMT's bylaws in late spring 2014, the authorities were legally required to complete this essential step towards strengthening the transport sector's regulatory framework by September. However, it now appears that AMT will not be fully operational before early 2015. ([4]) Another important programme left-over was centred on transferring more of the cost-savings resulting from the new port labour law from port concessionaires to end-users through a renegotiation of existing ports concessions. These negotiations are proceeding at a very slow pace, with little concrete progress made since the programme ended; in addition, focus seems to have shifted somewhat away from the original goal of reducing port usage costs for shippers. Part of the underlying problem appears to be a lack of resources within UTAP, the body within the Ministry of Finance overseeing the concession renegotiations. A number of other smaller-scale reforms in the ports sector (as summarised in the "chronogram" published by the Portuguese authorities as part of the programme) have not seen significant overall progress either. Finally, delays have also arisen in relation to liberalisation measures in railways and metropolitan public transport, notably completion of the public transport concessions in Lisbon and Porto and the privatisation of CP Carga. On the other hand, progress has been made with several infrastructure projects listed in Portugal's long-term transport plan, although the plan still lacks focus and a robust demand analysis underlying the proposed investments.

- **The enactment of decrees relating to regulators has been delayed further.** Under the programme, a new framework law setting out the main principles of the functioning of the principal National Regulatory Authorities (NRAs) and the Competition Authority was adopted. Following

([4]) In the meantime, IMT continues to carry on its previous regulatory tasks until AMT is fully operational.

this adoption, the by-laws of the respective NRAs were amended to reflect the principles of the new legal framework. The outstanding by-laws concerning the Securities Market Commission (CMVM), the Insurance Regulator (ISP) were approved by the Council of Ministers on 5 November 2014, while the Communications Regulator (ANACOM) and the Civil Aviation Authority (ANAC) decrees have not been approved yet. Renewed momentum and forceful actions are necessary to fully implement the NRAs framework which was an important programme commitment and a 2014 CSR.

• **Little progress has been made in reducing the late payment of commercial debts by the public administration.** The European Commission considered that Portugal has not properly transposed Directive 2011/7/EU into national law and decided in January 2014 to open an infringement case. Portugal received the formal notice regarding this infringement case in September 2014 with a deadline for replying by mid-November 2014.

• **Further progress is required to approve and enact the outstanding sector-specific decrees in compliance with the EU Service Directive.** No progress has been made to approve and enact the outstanding sector-specific legislation including the decree on the fees for construction permits, precious metal and universities. The latter still requires further amendments. Further efforts are therefore necessary to fully align those decrees with the principles of the European Service Directive.

• **Delays in ensuring a more open access to a number of highly regulated professions deserve close monitoring and actions.** None of the 18 by-laws regulating 19 professions, which were under revision during the programme, has been approved and enacted yet. Given the role of professional services for growth and innovation potential, decisive actions should be undertaken to eliminate regulatory barriers and excessive restrictions imposed by professional bodies.

Past achievements were attenuated in the following areas:

• **The agreement of government and social partners to increase the minimum wage to EUR 505, effective from 1 October 2014, may imply some risks for employment (in particular of more vulnerable workers) and overall competitiveness of the Portuguese economy.** The authorities informed that the increase in the minimum wage was a necessary condition to restart the dialogue with social partners for a new tripartite agreement on growth competitiveness and jobs. With the new increase in 2014, the prospects of transition into employment of the most vulnerable could deteriorate at a time when unemployment is still high, possibly aggravating the already existing labour market segmentation between insiders with jobs and outsiders without jobs. In this perspective, linking the minimum wage increase to economy-wide average productivity growth is problematic given that productivity developments at the lower end of the wage scale can be very different. Moreover, firms' cost and price competitiveness might suffer to some extent since the cut of the social security contribution rate (-3.2%) will only partly offset the minimum wage increase (+4.1%), and because it only applies to existing contracts at minimum wage conditions (see Annex 1).

• **Measures adopted in the area of collective bargaining could, on balance, make wages again less responsive to productivity developments.** Firstly, Law 55/2014 reduces the survival of collective agreements expired and not renewed and, in addition, introduces the possibility of a temporary suspension of sectoral collective agreements at firm level. While the reduction in the survival of collective agreements is expected to bring a new impetus to collective bargaining, the temporary suspension of collective agreements at firm level to increase the flexibility of the contractual adjustment in the firm is unlikely to be effectively applied, as it requires the agreement of the original signatory parts of the sectoral agreement. The authorities justified this requirement with the unions' monopoly power in collective bargaining which is granted by the Constitution. Secondly, the Council of Ministers Resolution 43/2014 changes the criteria for the extension of collective agreements in a way that a decision for an extension does no longer need to take into account the representativeness of signatory parts in the sector as was required since 2012. The change in the criteria was demanded by both employers and unions. The renewed generalisation of extensions of collective

agreements is likely to hinder efficient wage adjustment in lower-productivity firms. This measure represents a major setback in the reform of collective bargaining in Portugal.

• **The Government has recently approved amendments to the urban lease law which risk undermining the soundness and effectiveness of the overall framework.** In particular, changes to the commercial lease framework have enlarged the universe of companies covered by the transitional period ([5]) to micro enterprises, which represent around 95% of Portuguese companies, and to non-profit institutions which cover areas of 'national interest'. The already relatively long transitional period has also been extended by one additional year. A change has also been introduced to the legal regime of works in lease buildings, allowing the landlords to terminate the contract only in case of structural works that are validated by the municipalities. Eliminating legacy privileges and dual markets by shortening the transitory period and limiting its scope is key to make the housing market more dynamic. The authorities have not made efforts to develop more comprehensive and reliable monitoring procedures, which are essential to overcome the lack of data and systematic analysis of the impact of recent reforms in the housing market as well as its trend. The authorities announced their intention to step up efforts to fight tax evasion in the rental market. However, they have not provided the comprehensive study aimed at identifying the shadow economy in the rental market, which was requested under the programme.

([5]) The 2012 urban lease law envisaged a 5 year transitional period for the existing open-ended lease contracts signed before 1990 (around 30% of the total contracts), taking into account social criteria for vulnerable households and micro entities for commercial leases. An additional 2 year transitional period was foreseen for the commercial lease regime under certain circumstances.

4. SOVEREIGN FINANCING AND CAPACITY TO REPAY

Borrowing conditions have further improved since the end of the programme, amid general market optimism and a continued search for yield. Since May 2014, Portugal successfully established market presence with several medium- and long-term bond issuances. Regular auctions and syndications helped Portugal to meet its 2014 funding target and even allowed for pre-funding of some 2015 needs. Several bond auctions took place since the end of the adjustment programme. On 12 November, Portugal raised EUR 1.2 billion at a yield of 3.2% via a 10-year bond issuance. Two earlier bond auctions took place already in June and October, raising a total of EUR 2.1 billion, through a EUR 1 billion 10-year bond at 3.3% and a EUR 1 billion 5-year bond at 1.8%. Moreover, in September the Treasury managed to issue a EUR 3.5 billion syndicated 15-year bond at a coupon rate of 3.875%, which met healthy demand from institutional investors in particular outside the euro-area and overseas. Already in early July Portugal placed a 10-year dollar-denominated syndicated bond worth USD 4.5 billion (about EUR 3.3 billion) and the redemption of a EUR 5 billion bond on October 15 went smoothly. Since the exit from the programme, Portuguese bond yields in the secondary market have continued their downward path, decreasing to about 3% on 10-year bonds and ½% on 2-year bonds.

The Treasury has built a strong cash position. Disbursements of programme funds during the first half of 2014 and new bond issuances helped the Treasury to build a substantial cash buffer. The cash buffer, including deposits at commercial banks, amounted to about EUR 15 billion at end-September which is sufficient to cover financing needs until October 2015 when the only bond in 2015 is maturing (EUR 7.9 billion). An additional EUR 2.5 billion is being held in the special BSSF account (reduced from EUR 6.4 billion following the resolution of BES). In line with earlier statements by the Finance Minister, the debt agency informed the EC/ECB/IMF that the remaining deposits in the banking support fund BSSF would be used for state financing if need be. On 12 November, the final EFSM tranche of EUR 0.4 billion under the financial assistance programme was disbursed. As the government intends to continue its policy of refinancing SOE bank loans, the cash position is expected to weaken somewhat over the remainder of this year. In total, the Treasury expects SOE financing to amount to EUR 2.1 billion over the period September-December 2014. At present, the Treasury expects to end the year with a cash buffer of around EUR 10 billion, including the EUR 2.5 billion in the BSSF.

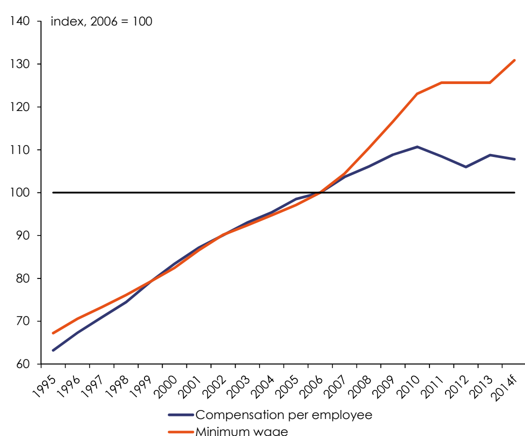
In the medium term, substantial sovereign financing challenges remain. At almost 130%, Portugal's public debt to GDP ratio is one of the highest in Europe and implies large roll-over needs in the coming years. Although Portugal will not have to redeem any EU loans in the coming years, the Treasury will have to raise on average about EUR 14 billion per year over the period 2015-2020 only to refinance currently outstanding medium and long-term debt. On top of this, it will have to fund budget deficits, accumulated arrears, as well as any unexpected needs, and to roll over the short-term debt stock which remains fairly high (about EUR 16 billion end September 2014). Portugal is currently benefitting from a global environment characterised by exceptionally low sovereign rates. Any deterioration in this environment will increase borrowing costs and may shift investor strategies.

ANNEX 1
The increase in the national minimum wage

Background

Decree-Law 144/2014 of 30 September implements a Government decision to increase the monthly guaranteed minimum remuneration (RMMG - paid 14 times per year) from EUR 485 to EUR 505. ([6]) An accompanying Decree-Law 154/2014 of 20 October implements a reduction of the social security contribution (TSU) by 0.75 percentage points due by employers for their workers receiving the RMMG without interruption since May 2014. Both decisions are effective from 1 October 2014 until 31 December 2015.

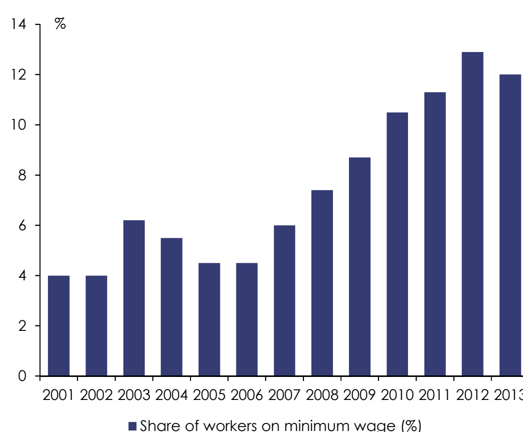
Graph A1.1: **Wage developments**



Source: Commission services

Article 59 of the Portuguese Constitution and, similarly, Article 273.2 of the Portuguese Labour Code oblige the State to establish and update the national minimum wage by taking into account, among other factors, the needs of workers, the increase in costs of living, productivity developments, and economic and financial stability. In 2006, when the RMMG stood at €386, social partners and Government signed an agreement with the objective of reaching a value of the RMMG of €500 by 2011. Reaching a level of €485 at the beginning of 2011, the Government in office at the time concluded in spring 2011 that the economic conditions for a further increase were no longer present. Since 2006 the increase in the RMMG outpaced average wage developments (see graph A1.1). In parallel, the proportion of workers receiving the minimum wage increased from 4% in 2001 to 12% in 2013, and this share is much higher for low-skilled and young people (see graph A1.2).

Graph A1.2: **Share of workers on minimum wage**



Source: MSESS - DG for Employment and Industrial Relations

From May 2011 to June 2014, during the EU/IMF adjustment programme for Portugal, the authorities committed that "any increase in the minimum wage will take place only if justified by economic and labour market developments and agreed in the framework of the programme review". An agreement between the Government and social partners signed on 24 September 2014 specifies the above-mentioned Government decisions and constitutes a tripartite committee "with a view to defining the criteria for the determination of future updates of the RMMG, with special attention to reconciling productivity, competitiveness and income and price policies."

The EU Council's recommendation on minimum wage developments in Portugal

A country-specific recommendation (CSR 2 as adopted on 8 July 2014) asks Portugal to "maintain minimum wage developments consistent with the objectives of promoting employment and competitiveness." The Government's Report on its draft budget 2015, adopted on 15 October, contains an overview table (Table 6.a) providing a summary of measures intended to address Portugal's various CSR action items. Regarding CSR 2, it maintains that *"the increase in minimum wage (4.1%) was less than the productivity*

([6]) Referring to their additional costs arising from insularity, the Autonomous Regions of Madeira and of Azores decided to have a RMMG which is 2% and 5% higher, respectively, compared to the Portuguese Continent.

evolution (4.3% in 2012 and 2013). Also, the effect of the increase on the overall remuneration levels in the economy is not significant (circa 0.25% of wages). Therefore, this increase does not compromise competitiveness or employment in a significant manner. Furthermore, as it allows for the partial recovery of the 7% loss (since 2011) in real purchasing power by minimum wage employees, it will have a positive effect on consumption (note that employees with low income have a very low propensity to save). Lastly, it should be noted that this increase will reduce inequalities in the Portuguese economy."

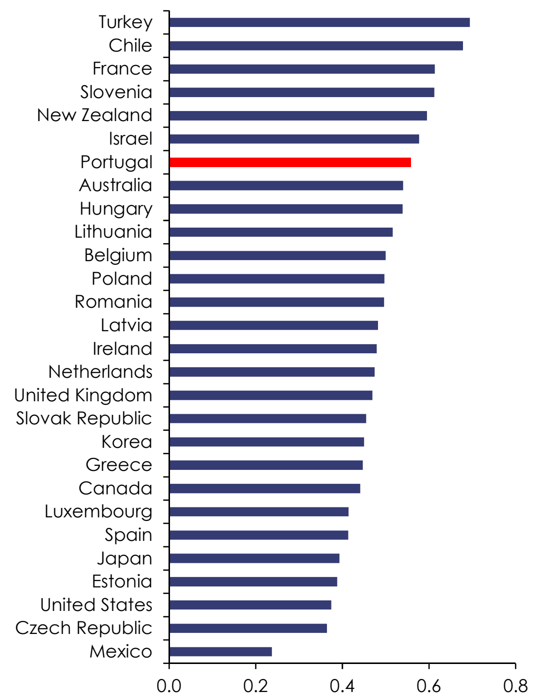
Possible economic and social impact

The increase in the RMMG could have a number of effects on employment, poverty and inequality, competitiveness, public finance, and growth:

• **Employment:** Two empirical studies produced in 2011 found negative employment effects of the 2006-2011 episode of high RMMG increases. ([7]) With the new increase in 2014, the prospects of transition into employment of the most vulnerable could deteriorate at a time when unemployment is still high, possibly aggravating the already existing labour market segmentation between insiders with jobs and outsiders without jobs. In this perspective, linking the RMMG increase to economy-wide average productivity growth is problematic given that productivity developments at the lower end of the wage scale can be very different.

• **Poverty and inequality:** The increase of the RMMG may help increase the income of those in employment, but it could make poverty more permanent for those who remain unemployed. Portugal's minimum wage is low in absolute terms, but so are average wages and productivity in Portugal. The RMMG stood at 38% of the average wage and 56% of the median wage in 2013 (35% and 49%, respectively, in 2000), which indicates a fairly high compression of the wage distribution, also in comparison to other countries (see graph A1.3). Compared to countries with similar income levels that are competing for the same types of foreign investment, notably central and eastern European countries, the Portuguese minimum wage is relatively high (see graph A1.4). In addition, it is worth noting that in 2013 the net income of a minimum wage worker in Portugal was about EUR 6580 per year, significantly above the at-risk-of-poverty threshold of EUR 4902.

Graph A1.3: **Minimum wage relative to median wage, 2013**



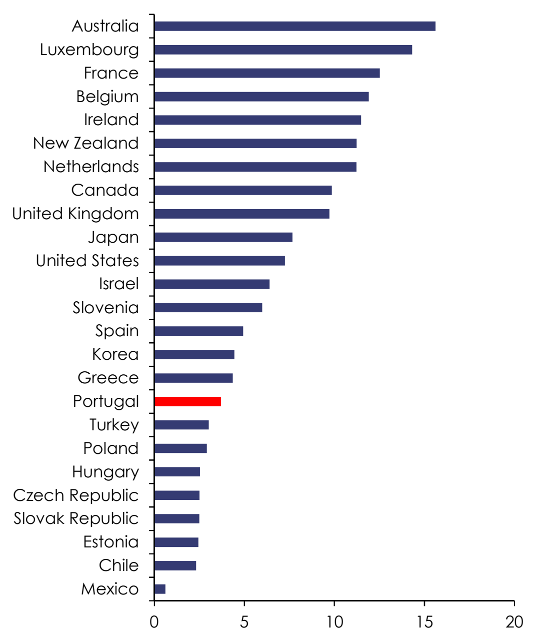
Source: OECD

• **Competitiveness:** Firms' cost and price competitiveness might suffer to some extent since the cut of the social security contribution rate (-3.2%) will only partly offset the RMMG increase (+4.1%) and because it only applies to existing contracts at RMMG conditions. Furthermore, many firms link wages for their lower-skilled employees to the RMMG. This in turn could have spill-over effects on wages far above the minimum wage. However, the economy-wide impact on average wages of this effect is uncertain. The literature suggests that firms, in reaction to the

([7]) A report on the RMMG carried out inside the Ministry of Economy and Employment at the end of 2012 (available at http://www.portugal.gov.pt/pt/os-ministerios/ministerio-da-economia-e-do-emprego/documentos-oficiais/20121216-salario-minino-2013.aspx) provides a data and literature overview and refers to the two studies: "Estudo sobre a Remuneração Mínima Mensal Garantida em Portugal – Relatório Final" by A. Carneiro, C. Sá, J. Cerejeira, J. Varejão e M. Portela (September 2011); and "The Impact of the Minimum Wage on Low-wage Earners" by M. Centeno, C. Duarte and A. Novo, Banco de Portugal – Economic Bulletin (Autumn 2011).

minimum wage increase, try to keep their overall wage cost unchanged by compressing the wage distribution, which can negatively impact productivity. Overall, competitiveness gains attained over recent years, which supported the external rebalancing of the economy, might be slowed down or even partially reversed, notably if not accompanied by other reforms that reduce labour market segmentation and contribute to wage formation in line with productivity developments.

Graph A1.4: **Minimum wage per hour in USD**



Source: OECD

- **Public finance:** Preliminary calculations suggest that the overall direct budgetary impact is negative but relatively small. Lower social security contributions from employers and higher expenditure for workers paid the RMMG in the public sector will be partly offset by increased tax and social security revenues from the employees receiving a higher minimum wage. However, economy-wide second-round effects could amplify the budget impact.

- **Growth:** A full assessment of the increase in the RMMG would also have to consider aggregate demand-side effects translating into effects on growth. Whether there is a negative or positive demand effect from the RMMG increase will depend largely on the balance between the higher income of those employed and the possible income loss from jobs that would have been created at a lower minimum wage. In case of a positive balance, the underlying standard assumption is that low-wage earners have a low savings rate and use most of their wage increases for consumption with stimulating effects for growth. Lower company profits and higher prices of non-tradable goods might reduce the positive real income effects. Furthermore, higher domestic demand might be partly met by more imports, thus slowing down the required process of external adjustment, in addition to the possible losses in price competitiveness mentioned above. Finally, the possible supply-side effects of higher wages also need to be taken into account as they may lead to changes in labour demand and supply with an impact on potential growth. The overall effects of these complex interactions can only be captured through a model-based simulation.

Conclusion

The economic and social effects of the RMMG increase will ultimately depend on the balance between the higher incomes of those already employed compared to the losses of those who could face more difficulties to transition from unemployment into a new job. While the immediate effects on employment, poverty, competitiveness and the budget might be relatively small, there is a risk that it slows down the ongoing processes of reducing the high unemployment, especially for the young and unskilled worker, and of rebalancing the economy which might in turn trigger second-round effects that are difficult to project at this stage. The steep increase in the RMMG between 2006 and 2011, which deviated from general wage developments and made the minimum wage a binding constraint for an ever bigger share of employees, suggest that an extended period of more moderate increases in the RMMG would have been more prudent to avoid risks to the nascent recovery of the Portuguese economy and labour market. Such step-wise increases should ideally be accompanied by further reforms on the labour market to reduce its segmentation and improve the functioning of the wage bargaining system.

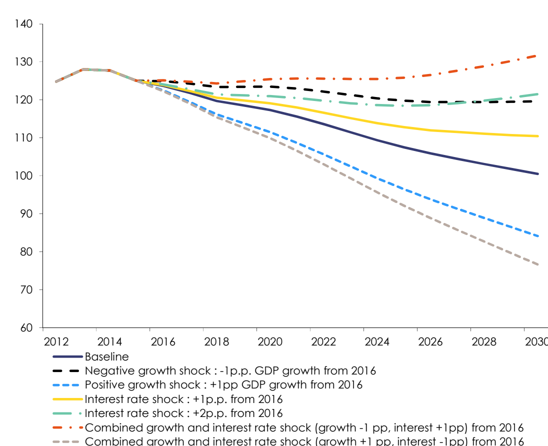
ANNEX 2
Debt sustainability analysis

Under the projections of the Commission Autumn Forecast 2014, government debt is projected to reach 127.7% of GDP by end-2014, down from 128.0% of GDP at end-2013, and to continue declining progressively thereafter. The comparison with the latest published forecasts is somewhat distorted by changes related to the new ESA 2010 accounting standards as from October 2014. The decline of the debt-to-GDP ratio in the baseline scenario is supported by the projected economic recovery, expected primary budget surpluses as well as the likely use of cash reserves and other debt-reducing operations. The baseline long-term calculations shown below incorporate the Autumn Forecast until 2016, which includes fiscal consolidation measures up to 2015 and reflects no-policy-change assumptions for 2016. The outer years are based on technical assumptions. In particular, it is assumed that: (i) the structural primary fiscal balance remains unchanged at a surplus of 2.1% of GDP as from 2018; (ii) nominal interest rates are around 4-4.5%; (iii) nominal GDP growth is between 3.0% and 3.5%; and (iv) ageing costs are taken into account following the Commission's 2012 Ageing Report projections.

The scenario of the Autumn Forecast and a medium-term nominal growth rate of 3-3.5% are compatible with a gradual decline of the debt ratio over a long-term horizon. Nevertheless, given the very high starting point, the debt ratio is projected to remain above its pre-crisis level for a significant number of years, not falling below 100% of GDP before 2030. Moreover, the sensitivity analysis suggests that the declining debt-to-GDP trajectory is sensitive to financial market volatility and it remains vulnerable to negative economic developments. The graphs below present a sensitivity analysis with respect to macro-economic and financial market risks, the effect of alternative fiscal consolidation paths, and the potential impact of contingent liabilities such as reclassifications and other changes in the government perimeter.

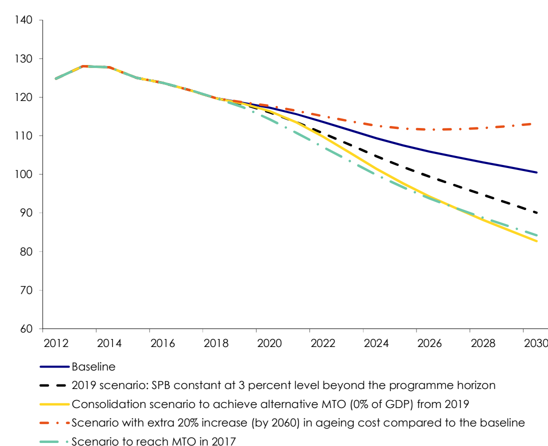
Graph A2.1 illustrates the sensitivity of the debt trajectory to economic assumptions by considering a shock to real GDP growth and hikes in interest rates as from 2016. The analysis suggests that a lower GDP growth rate by one percentage point or a higher interest rate on maturing and new debt by two percentage points could put on hold the declining debt-to-GDP trend in the long run. Moreover, a combined growth and interest shock could put the debt on an explosive path. Conversely, a positive shock to medium and long-term growth on account of the structural reforms undertaken would result in visibly lower debt-to-GDP ratios and a faster pace of debt reduction. [8] Combined with lower interest rates, the pace of the debt reduction could increase even further.

Graph A2.1: Macroeconomic risks: growth and interest rates (debt as percent of GDP)



Source: Commission services

Graph A2.2: Fiscal consoidation and ageing costs (debt as percent of GDP)



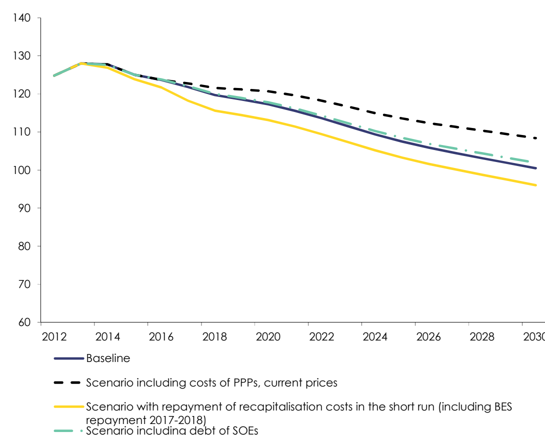
Source: Commission services

Additional fiscal consolidation would clearly accelerate the debt reduction path (Graph A2.2). In particular, reaching the Medium-Term-Objective

(8) Not taking into account the positive indirect effects of the higher GDP growth on the fiscal balance.

(MTO) of a structural deficit of 0.5% of GDP in 2017 as per Fiscal Compact requirements would require a cumulative fiscal effort of about 1.2% of GDP in 2016 and 2017 and reaching a primary surplus of over 4% by 2017. Maintaining the MTO over the longer term horizon will require primary surpluses of around 4% up to the middle of the next decade, declining gradually to close to 3.5% until the end of the projection horizon. Under these assumptions, the debt-to-GDP ratio would accelerate its decline, falling below the pre-crisis level around the middle of the next decade and maintaining the sustained downward path thereafter. A slower pace of consolidation but aiming at a more ambitious MTO of zero percent would also accelerate the debt reduction. On the other hand, if ageing costs are allowed to rise significantly (simulated as a 20% increase), ([9]) the fall in the ratio would be severely curtailed and may be even reversed in the long run in the absence of compensating fiscal consolidation.

Graph A2.3: **Changes in the General Government perimeter (debt as percent of GDP)**



Source: Commission services

Graph A2.3 illustrates the impact of changes in the government perimeter. The inclusion of all gross costs of PPPs would lead to an increase in the level of the government debt and delay, but not put at peril its decline. Risks related to the debt of SOEs outside the General Government perimeter remain limited. In addition, the envisaged privatisation programme combined with the necessary reforms to reduce SOEs operational costs will also contain the risks stemming from SOEs. By the same token, a quick repayment of the bank recapitalisation funds to the Government would accelerate the adjustment towards lower debt-to-GDP ratios.

Overall, the debt sustainability analysis reveals that the debt reduction path of the central scenario is vulnerable in particular to macro-economic and financial-market developments. At the same time, the declining trajectory of the debt-to-GDP ratio can be supported by maintaining fiscal discipline over the medium-to-long-term horizon and standing ready to take action should the economic recovery slow down. In addition, the solid reduction path crucially hinges on medium and long-term economic growth, which points to the necessity of persevering with the implementation of structural reforms. On the positive side, risks stemming from contingent liabilities outside the general government perimeter appear to have been successfully contained.

([9]) According to the EU ageing report, Portugal is currently among the low-risk countries where the increase in age related expenditure is amongst the lowest in Europe.

ANNEX 3

Commission services macroeconomic and fiscal projections 2013-2016

Table 1: Use and supply of goods and services (volume)

Annual % change	2013	2014	2015	2016
1. Private consumption expenditure	-1.4	1.6	1.5	1.5
2. Government consumption expenditure	-1.9	-0.4	-0.3	0.2
3. Gross fixed capital formation	-6.3	1.9	2.4	2.8
4. Final domestic demand	**-2.3**	**1.2**	**1.3**	**1.4**
5. Change in inventories	--	--	--	--
6. Domestic demand	**-2.4**	**1.2**	**1.3**	**1.4**
7. Exports of goods and services	6.4	3.6	4.6	5.6
7a. - of which goods	5.8	3.5	4.8	6.0
7b. - of which services	8.2	4.0	4.2	4.6
8. Final demand	**0.0**	**1.9**	**2.2**	**2.7**
9. Imports of goods and services	3.6	4.5	4.7	5.0
9a. - of which goods	4.1	4.7	5.0	5.4
9b. - of which services	0.8	3.2	2.9	2.8
10. Gross domestic product at market prices	**-1.4**	**0.9**	**1.3**	**1.7**
Contribution to change in GDP				
11. Final domestic demand	-2.3	1.2	1.3	1.4
12. Change in inventories + net acq. of valuables	-0.1	0.0	0.0	0.0
13. External balance of goods and services	1.0	-0.3	0.0	0.3

Table 2: Use and supply of goods and services (value)

Annual % change	2013	2014	2015	2016
1. Private consumption expenditure	-0.7	2.4	2.4	2.3
2. Government consumption expenditure	4.3	-0.4	0.3	0.9
3. Gross fixed capital formation	-6.4	3.0	5.5	8.5
4. Final domestic demand	**-0.7**	**1.9**	**2.5**	**3.1**
5. Change in inventories	--	--	--	--
6. Domestic demand	**-0.7**	**1.9**	**2.5**	**3.0**
7. Exports of goods and services	6.1	3.0	6.8	6.7
8. Final demand	**1.1**	**2.2**	**3.7**	**4.1**
9. Imports of goods and services	1.6	2.8	6.2	6.3
10. Gross national income at market prices	1.7	2.0	2.7	3.2
11. Gross value added at basic prices	1.2	1.8	2.2	3.2
12. Gross domestic product at market prices	**0.9**	**2.0**	**2.7**	**3.2**
Nominal GDP, EUR bn		174.7	179.4	185.3

Table 3: Implicit price deflators

% change in implicit price deflator	2013	2014	2015	2016
1. Private consumption expenditure	0.7	0.8	0.9	0.9
2. Government consumption expenditure	6.4	0.1	0.6	0.7
3. Gross fixed capital formation	-0.1	1.0	3.0	5.6
4. Domestic demand	**1.6**	**0.7**	**1.2**	**1.6**
5. Exports of goods and services	-0.3	-0.6	2.1	1.0
6. Final demand	**1.1**	**0.3**	**1.4**	**1.4**
7. Imports of goods and services	-1.9	-1.7	1.5	1.2
8. Gross domestic product at market prices	**2.3**	**1.1**	**1.4**	**1.5**
HICP	**0.4**	**0.0**	**0.6**	**0.9**

Table 4: Labour market and cost

Annual % change	2013	2014	2015	2016
1. Labour productivity (real GDP per employee)	1.6	-0.7	0.5	0.9
2. Compensation of employees per head	3.5	-0.4	0.9	0.9
3. Unit labour costs	**1.9**	**0.3**	**0.4**	**0.0**
4. Total population	-0.5	-0.6	-0.5	-0.5
5. Population of working age (15-64 years)	-1.1	-0.6	-0.5	-0.4
6. Total employment (fulltime equivalent)	-2.9	1.6	0.8	0.8
7. Calculated unemployment rate - Eurostat definition (%)	**16.4**	**14.5**	**13.6**	**12.8**

Table 5: External balance

levels, EUR bn	2013	2014	2015	2016
1. Exports of goods (fob)	49.3	50.6	54.1	57.9
2. Imports of goods (fob)	56.2	57.9	61.6	65.6
3. Trade balance (goods, fob/fob) (1-2)	**-6.9**	**-7.2**	**-7.5**	**-7.7**
3a. p.m. (3) as % of GDP	***-4.0***	***-4.1***	***-4.2***	***-4.1***
4. Exports of services	18.0	18.6	19.8	20.9
5. Imports of services	9.4	9.5	10.0	10.4
6. Services balance (4-5)	**8.6**	**9.1**	**9.8**	**10.5**
6a. p.m. 6 as % of GDP	***5.0***	***5.2***	***5.5***	***5.7***
7. External balance of goods & services (3+6)	**1.7**	**1.9**	**2.4**	**2.8**
7a. p.m. 7 as % of GDP	***1.0***	***1.1***	***1.3***	***1.5***
8. Balance of primary incomes and current transfers	-2.1	-2.2	-2.2	-2.3
8a. - of which, balance of primary income	*-3.8*	*-3.9*	*-4.0*	*-4.2*
8b. - of which, net current Transfers	*1.6*	*1.7*	*1.8*	*1.9*
8c. p.m. 8 as % of GDP	*-1.2*	*-1.2*	*-1.2*	*-1.2*
9. Current external balance (7+8)	**-0.4**	**-0.3**	**0.2**	**0.5**
9a. p.m. 9 as % of GDP	***-0.3***	***-0.2***	***0.1***	***0.3***
10. Net capital transactions	2.7	2.7	2.8	2.9
11. Net lending (+)/ net borrowing (-) (9+10)	**2.2**	**2.5**	**3.0**	**3.5**
11a. p.m. 11 as % of GDP	***1.3***	***1.4***	***1.7***	***1.9***

Table 6: Fiscal accounts

	2013	2014	2015	2016
		% of GDP		
Indirect taxes	13.7	14.0	14.5	14.5
Direct taxes	11.3	10.7	10.8	10.8
Social contributions	11.9	11.8	11.5	11.4
Actual	8.7	8.8	8.7	8.6
Imputed	3.3	3.1	2.8	2.8
Sales and other current revenue	7.2	7.1	6.7	6.6
Sales	4.0	4.0	3.8	3.8
Other current revenue	3.2	3.1	2.8	2.9
Total current revenue	**44.2**	**43.6**	**43.4**	**43.3**
Capital transfers received	1.0	1.0	1.0	1.0
Total revenue	**45.2**	**44.6**	**44.4**	**44.2**
Compensation of employees	12.4	11.7	11.0	10.8
Intermediate consumption	5.7	5.8	5.9	5.8
Social transfers in kind via market producers	1.9	1.9	1.9	1.9
Social transfers other than in kind	18.4	17.6	17.4	17.2
Interest paid	5.0	5.0	5.0	4.9
Subsidies	0.6	0.9	0.6	0.6
Other current expenditure	3.0	2.9	3.2	3.2
Total current expenditure	**46.9**	**45.9**	**45.0**	**44.3**
Gross fixed capital formation	2.2	2.5	2.4	2.5
Other capital expenditure	1.0	1.1	0.3	0.3
Total expenditure	**50.1**	**49.5**	**47.7**	**47.1**
General Government balance (ESA2010)	**-4.9**	**-4.9**	**-3.3**	**-2.8**
		% change		
Indirect taxes	0.7	3.9	6.4	3.4
Direct taxes	27.9	-3.2	2.9	3.2
Social contributions	4.5	1.3	-0.2	2.1
Sales and other current revenue	4.2	0.1	-3.2	2.9
Total current revenue	**8.3**	**0.8**	**2.2**	**3.0**
Capital transfers received	-41.3	-5.6	3.0	3.7
Total revenue	**6.2**	**0.6**	**2.2**	**3.0**
Compensation of employees	6.3	-4.0	-3.0	1.4
Intermediate consumption	3.5	3.5	3.6	1.9
Social transfers in kind via market producers	0.2	2.8	-0.1	1.1
Social transfers other than in kind	5.7	-1.9	1.6	1.9
Interest paid	2.1	3.0	1.2	1.5
Subsidies	-3.1	57.5	-27.4	1.1
Other current expenditure	5.7	0.7	10.8	2.9
Total current expenditure	**4.8**	**-0.2**	**0.6**	**1.8**
Gross fixed capital formation	-13.7	16.7	2.0	5.9
Other capital expenditure	31.0	18.9	-73.0	3.4
Total expenditure	**4.3**	**0.9**	**-1.1**	**2.0**
Nominal GDP, EUR bn	171.2	174.7	179.4	185.3

Table 7: Government debt developments

	2013	2014	2015	2016
ESA2010 deficit (% of GDP)	**-4.9**	**-4.9**	**-3.3**	**-2.8**
ESA2010 gross debt (% of GDP)	128.0	127.7	125.1	123.7
	levels, EUR bn			
ESA2010 deficit	**-8.3**	**-8.6**	**-6.0**	**-5.3**
Gross debt	219.2	223.2	224.4	229.2
Change in gross debt	7.4	3.9	1.2	4.8
Nominal GDP	171.2	174.7	179.4	185.3
Real GDP	191.3	189.5	187.1	183.8
Real GDP growth (% change)	**-1.4**	**0.9**	**1.3**	**1.7**
Change in gross debt (% of GDP)	4.3	2.3	0.7	2.6
Stock-flow adjustments (% of GDP)	-0.5	-2.7	-2.6	-0.3
	% of GDP			
Gross debt ratio	**128.0**	**127.7**	**125.1**	**123.7**
Change in gross debt ratio	3.2	-0.3	-2.7	-1.3
	Contribution to change in gross debt			
Primary balance	-0.1	-0.1	-1.6	-2.0
"Snow-ball" effect	3.7	2.4	1.5	0.8
of which				
Interest expenditure	*5.0*	*5.0*	*5.0*	*4.9*
Real growth effect	*1.7*	*-1.2*	*-1.7*	*-2.2*
Inflation effect	*-2.9*	*-1.4*	*-1.8*	*-1.9*
Stock-flow adjustments	**-0.5**	**-2.7**	**-2.6**	**-0.3**
Implicit interest rate	*4.0*	*4.0*	*4.0*	*4.0*

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